

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM           )  
FOR REGULATING RATES AND CLASSES       )       Docket No. RM2017-3  
FOR MARKET DOMINANT PRODUCTS           )

**DECLARATIONS SUPPORTING COMMENTS OF  
ALLIANCE OF NONPROFIT MAILERS,  
ASSOCIATION FOR POSTAL COMMERCE, AND  
MPA—THE ASSOCIATION OF MAGAZINE MEDIA**

**(March 20, 2017)**

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**DECLARATION OF META A. BROPHY  
ON BEHALF OF CONSUMER REPORTS, INC.**

I, Meta A. Brophy, declare as follows:

1. I am the Director, Procurement Operations for Consumer Reports, Inc. ("CR"). CR is a nonprofit organization exempt from income tax under the Internal Revenue Service Code Sections 501(c)(3), and is headquartered in Yonkers, NY. CR's business address is 101 Truman Ave., Yonkers, NY 10703.

2. I have worked for CR for more than 31 years and served in my current position for more than 12 years. As Director, Procurement Operations, I oversee all aspects of the CR marketing procurement process, including supplier selection, contract management and supplier relationship management, providing advice, counsel, and services to internal business groups. Additionally, Procurement Operations staff manages all the United States Postal Service business accounts and is responsible for monitoring service, delivery, and expense.

3. I serve as President, Board of Directors, Alliance of Nonprofit Mailers ("ANM") and have since 2008, and on the ANM Executive Committee since 2005. In my roles at CR and ANM, I have accumulated extensive experience in nonprofit direct mail

marketing, manufacturing, and distribution, while working for affordable rates and reliable service from the Postal Service.

4. CR is an independent, nonprofit organization that works with consumers to create a fairer, safer, and healthier marketplace. Founded in 1936, CR has achieved major gains for consumers on health reform, food and product safety, financial reform, and other issues. The organization has advanced important policies to cut hospital-acquired infections; prohibit predatory lending practices; and combat dangerous toxins in food. CR tests and rates thousands of products and services in its 50-plus labs, state-of-the-art auto test center, and consumer research center. CR works for pro-consumer laws, regulations, and practices in Washington, DC, the states, and in the marketplace. CR serves more than eight million subscribers to its flagship magazine, website and other publications.

5. This work, which includes product testing, is costly but important and effective. In the last year, CR test results prompted manufacturers to make positive changes to oven range models, bike helmets, and several strollers and high chairs due to issues uncovered in our labs. While inspecting an SUV, CR discovered a top-tether anchor in one of the seats missing, and notified the automaker, who issued a safety recall. CR buys all of the products it tests at retail, just as a consumer would.

6. Consumer Reports accepts no advertising, payment or other support from the companies whose products we evaluate. We don't accept free test samples from manufacturers. We don't allow our name or content to be used for any promotional purposes. Our funding comes primarily from subscribers and donors.

7. CR relies on the U.S. Postal Service to attract new subscribers and donors through direct mail solicitations and to deliver CR's subscriber mail (Consumer Reports magazine, Consumer Reports on Health newsletter, acquisition promotions or premiums, special interest publications, acknowledgments, bills, and renewal and gift notices). Half of CR's revenue is generated from print subscriptions and donations acquired through direct mail acquisition, retention, and fundraising campaigns. Our most important classes of mail remain First-Class, nonprofit Periodicals Mail, and nonprofit Standard Mail. CR spent nearly \$30,000,000 (13 percent of operating expenses) on postage in the United States in our fiscal year 2016, \$32,000,000 (14 percent of operating expenses) in fiscal year 2015, and \$34,000,000 (15 percent of operating expenses) in fiscal year 2014.

8. We must attract new subscribers and service existing subscribers in the most cost-effective way possible. Over the past decade, distribution costs have fluctuated with fuel prices. Other goods and services that we purchase through competitive bidding, such as premiums, mail package inserting, list and data costs have remained flat. The printing and paper manufacturing industries have experienced sweeping consolidation and capacity reduction. Decreases in printing prices offset occasional, nominal paper increases. Postage, however, has increased steadily eight out of ten years. For the classes and categories of mail that CR uses, the price increases often have exceeded the overall rate of inflation as measured by the Consumer Price Index.

9. Postage increases reduce CR mail volume. When we don't grow our acquisition base through direct mail, we also don't renew a commensurate number of

subscribers and donors through the mail, and we don't send as many publications through the mail. It goes without saying that when we cut mail volume, the entire supply chain that serves our needs sees their revenue and income reduced.

10. During the recession that began in 2007, CR experienced a falloff in subscriptions and revenue that required taking a number of austerity measures. Among our responses was a de-emphasis of print publications in favor of digital media. In 2015, CR discontinued two smaller print publications, ShopSmart magazine and the Money Adviser newsletter. Shuttering these monthly publications meant the elimination of 6 managerial and 11 union positions. ShopSmart fulfilled 324,000 and Money Adviser 135,000 print subscriptions.

11. Consumer Reports magazine serves four million print subscribers, who prefer to receive magazines and other sources of information through the mail. CR's ability to find and keep subscribers and donors who want to receive print publications and communications would be greatly impaired, however, if the CPI cap were to be removed and the Postal Service freed to increase postal rates faster than inflation. Above-inflation rate increases would accelerate diverting resources away from direct mail operations.

12. It is for these reasons that Consumer Reports supports the existing rate regulatory system that adheres to the CPI price cap as its centerpiece. Allowing the Postal Service to increase postal rates faster than inflation is likely to have a negative effect on our ability to acquire and retain customers and donors who support our operations and allow us to work with consumers to create a fairer, safer, and healthier marketplace.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 9, 2017.

  
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Meta A. Brophy  
Consumer Reports, Inc.

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**DECLARATION OF TRACEY BURGOON  
ON BEHALF OF DISABLED AMERICAN VETERANS**

I, Tracey Burgoon, declare as follows:

1. I am the Director of Direct Marketing for Disabled American Veterans ("DAV"). DAV is a charitable organization that was incorporated by an Act of Congress on June 17, 1932, and is exempt from federal income tax under Internal Revenue Code Section 501(c)(4). My business address is located at our national headquarters: 3725 Alexandria Pike, Cold Spring, KY 41076.

2. I have worked for DAV for over 19 years, and have served in my current position for over four years. As DAV's Director of Direct Marketing, I manage the charity's direct mail, telemarketing, and direct response television fundraising and outreach efforts aimed at existing and potential donors. I also represent DAV as a Member of the Board of Directors of the Alliance of Nonprofit Mailers.

3. My position requires that I fulfill several postal-related duties in support of DAV's charitable mission. I develop and manage the number of pieces mailed by or on behalf of DAV annually, and I also analyze the value of postage paid by the organization – all with an eye toward generating sufficient financial support from our donor base to

support the services that DAV provides to our nation's veterans. In addition, I work with the U.S. Postal Service to manage the performance of our caging operation.

4. As the daughter of a disabled veteran, the wife of an Army veteran, and the mother of an Air Force airman, I am very proud of the work that DAV does for our veterans. DAV helps veterans obtain the full range of benefits available to them and represents claimants before the Department of Veterans Affairs. It advocates for veterans' interests on Capitol Hill. The organization also educates the public about the great sacrifices and needs of veterans who are transitioning back to civilian life.

5. Use of direct mail – primarily nonprofit outgoing and first class return mail - is vital to our organization's ability to disseminate important information, raise funds, and fulfill its charitable purpose. Direct mail generates more than 85 percent of DAV's annual donations and more than 90 percent of its membership dues. In 2016, DAV spent nearly \$12 million on standard postage, over \$1 million on periodical postage, and nearly \$8 million on first class postage stamps for return mail. It also spent approximately \$200,000 on business reply envelope postage for return mail and generated more than \$500,000 in additional first class return postage.

6. The need for DAV's services, and the central role that direct mail plays in effectuating those services, is greater than ever. Our nation's military continues to engage in conflicts globally, while our servicemen and women are increasingly surviving catastrophic injuries due to medical advances. DAV has therefore created new programs to help these veterans, such as transition services, career fairs and employment opportunities, winter/summer rehabilitation events, programs for children of ill, injured, and fallen veterans, and mobile service units that enable us to reach veterans in rural

locations. These newer programs supplement DAV services that have existed for nearly a century, such as outreach and care for veterans with brain injuries.

7. Unfortunately, while the need for DAV's services has grown, rising postal rates and challenging economic conditions have limited our reach and resources. Since 2013, the number of DAV donors has declined by approximately ten percent. Our net income is decreasing by an even greater rate, and rising nonprofit postal rates is a strong contributing factor to that decline. In short, DAV has been unable to maintain the mailing volume necessary to maintain its former levels of public support.

8. Removing the CPI cap and freeing the Postal Service to raise postal rates faster than inflation would devastate DAV's ability to raise significant funding to support veterans and their families. Our operating budget depends almost exclusively on donations from the general public, and our ability to reach that public and ask for financial support depends predominantly on direct mail.

9. In response to continued postage rate increases, DAV's leadership has instructed me to seek alternative channels by which to raise funds, such as telemarketing, direct response television, electronic media, and peer-to-peer online fundraising. Removing the CPI cap on postal rate increases would undoubtedly accelerate a move away from direct mail fundraising and education.

10. However, it is unclear that alternative solicitation channels will be viable for DAV. Telemarketing is both more expensive and invasive, and electronic media and online platforms are far less suitable for our elderly donor base, many of whom do not engage in e-commerce or are reluctant to donate online with a credit card. Additional postal rate increases will therefore push DAV into the untenable position of having to

further reduce the volume of mail sent each year (including the number of business reply envelopes, which will consequently reduce the number of donations received by reply mail), while substituting less effective fundraising methods. Ultimately, the great programs that DAV maintains to support our nation's veterans will decline in number dramatically.

11. Further declarant sayeth not.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 10, 2017.

A handwritten signature in purple ink, appearing to read "Tracey Burgoon", is written over a horizontal line.

Tracey Burgoon  
Disabled American Veterans

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**DECLARATION OF RITA D. COHEN**

My name is Rita D. Cohen. I am Senior Vice President for Legislative and Regulatory Policy at the MPA – The Association of Magazine Media. I have worked for MPA since 1995. I testified before the Postal Rate Commission, the predecessor to the Postal Regulatory Commission, in a number of rate cases conducted under the pre-PAEA regulatory system. I am trained as an economist and statistician, and received Bachelors’ and Masters’ degrees from the University of Pennsylvania.

MPA’s membership consists of about 100 publishing companies with close to 1000 magazine brands. The membership varies from large media companies with national, large-circulation, multi-media brands to companies with niche and local publications, some publishing a single title and others with large portfolios of enthusiast titles. Virtually all members rely heavily on the Postal Service to deliver print magazines to their readers. The past decade has been a time of rapid transformation in the magazine media industry, and many magazine media brands have vibrant and well-visited websites, active and expanding social media presence, and a growing array of events. However, the brands remain rooted in the print experience, the heart and soul of magazine media. Our reliance and dependence on

the Postal Service remains as strong today as before the digital “revolution” and MPA’s members are very concerned about the Postal Service’s stated desire (most recently expressed in the Postmaster General’s February 7 testimony to the House Committee on Oversight and Government Reform) to eliminate the price cap on postage for market dominant products.

To inform the Commission’s deliberations in this ten-year review, I conducted a survey of MPA members. The survey included a series of questions on members’ postage and other manufacturing, production, and distribution costs; members’ volumes in each class of mail; measures undertaken by members in recent years to control postal expenses; and the potential impact of a significant postal rate increase on member operations and volumes. To gain insight from multiple perspectives, the survey was disseminated to the MPA Board of Directors, the Board of the MPA’s Independent Magazine Group (IMAG), and members of the MPA postal committee.

This declaration presents some aggregate results from the survey and a summary of key facts from a substantial portion of total periodicals volume. We urge the Commission to keep these results in mind as it considers several of the objectives that PAEA was designed to achieve.

**1. Respondents to the survey represent 40 percent of periodicals volume.**

MPA received survey responses from 22 publishing companies with 280 individual titles. In 2015, the respondents sent 2.3 billion pieces of Periodicals mail. This represents 40 percent of total Periodicals mail volume.

## **2. Magazines continue to send substantial volumes of Standard Mail and First-Class Mail Letters to support magazine subscriptions.**

As the Commission is well aware, one of the areas of greatest frustration for MPA and its members over the years has been the continuous and unexplained increases in Periodicals unit costs (while we undertook more and more worksharing), leading the class to be deemed “underwater” according to the Commission’s attributable cost methodology. Elsewhere in our comments, we deal extensively with some of the Postal Service’s management decisions that have hurt industry efforts to stem the growth in Periodicals costs. Nevertheless, as both the Postal Service and Commission have recognized, magazine subscriptions generate allied mailings, such as acknowledgments, renewal notices, invoices, and solicitations and the contribution of these mailings offsets a substantial portion of the shortfall in measured Periodicals costs.

In 2015, survey respondents mailed 1.4 billion pieces of First-Class Mail and Standard Mail, over sixty percent of their Periodicals volume. In an effort to control postage costs, most of these mailings were Standard Mail Letters. Using unit contributions for Periodicals, Standard Mail Letters, and First-Class Mail Presort Letters from the Public Cost and Revenue Analysis (CRA), I calculate that respondents’ First-Class Mail and Standard Mail offset 70 percent of the measured shortfall in contribution from respondents’ Periodicals mail. (See Exhibit 1.)

**3. Postage costs represent a growing percentage of production costs as publishers and their vendors have been more successful in reducing costs or at least holding the line on other manufacturing, production, and distribution costs.**

The three main cost components for manufacturing, producing, and distributing magazines are paper, printing, and postage. We asked survey respondents for their postage costs and their total manufacturing, production, and distribution costs for 2011 to 2015. We also asked them to estimate the percentage that postage represented of manufacturing, production, and distribution costs in 2006, the year PAEA went into effect.<sup>1</sup>

The results showed that despite the CPI price cap, postage has become a much larger percentage of manufacturing, production, and distribution costs over the last decade, increasing from 26 percent in 2006 to 38 percent in 2015. We urge the Commission to take note of this statistic in evaluating the Postal Service's complaint about having to live with CPI-based price increases. Many companies and entire industries have adjusted their business and economics to current market conditions, with far smaller price increases or price reductions over the same time period.

**4. Publishers have taken aggressive steps to try to keep postage costs under control since 2011.**

We asked survey respondents to tell us the number of magazines that were closed, reduced frequency, and/or cut circulation since 2011. While not every change was solely due to postage increases, postage is such a large expense for magazine

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<sup>1</sup> Two respondents provided estimates for the percentage that postage represented in 2009, because 2006 data were unavailable.

publishers that it always figures in the mix of reasons for cost-cutting measures, and ultimately in the decision to cease producing a print version of a magazine.

The survey respondents were quite active in cutting costs since 2011. Forty-five titles reduced frequency during this period and 68 cut circulation, thereby mailing fewer copies. Another 43 titles were closed over the same time period.

**5. Previous cost cutting measures pale in comparison to the dramatic decreases in Periodicals volume that would result from rate increases significantly greater than CPI.**

To gauge the impact going forward of significant postage increases, we asked survey respondents both a more qualitative and a quantitative question. First, we asked publishers the number of titles that would consider several cost cutting measures if postage increased substantially more than inflation. Table 1 summarizes the expected response of publishers to postage increases of 10 or 15 percent above CPI.

**Table 1. Percentage of Titles**

<b>Response If Periodicals Rates Increase By...</b>	<b>10% Above Inflation</b>	<b>15% Above Inflation</b>
Close magazine	10%	22%
Go digital only	11%	14%
Cut frequency	15%	22%
Decrease paper weight and/or grade	23%	33%
Reduce trim size	11%	17%
Cut circulation	20%	23%
Increase use of alternate delivery	16%	19%
Reduce staffing	51%	59%

To get an overall measure of the quantitative impact, we asked publishers to estimate the percentage change in their Periodicals volume in response to substantially above-inflation rate increases.

Publisher responses dramatically illustrate the damage that postage increases will have on our industry. At CPI plus 10 percent, publishers estimated their Periodicals volume would decrease by 27 percent. At CPI plus 15 percent, the impact was even more dramatic, with survey respondents estimating volume decreases of 34 percent. Following compilation of the survey results, I summarized the responses at a meeting of the MPA Executive Committee. I told the members what the survey showed with respect to potential volume declines in the event of rates increases as big as CPI plus 10 percent and CPI plus 15 percent. I informed the members that the

PRC has generally estimated that postal volumes are relatively inelastic, meaning that volumes decrease less than rates increase in the event of a rate change. Despite that, the group believed that the volume falloff could be even larger than survey responses indicated. Pressure on their business models, based on the recent changes in the media ecosystem, have left them much less room to withstand significant increases in any part of their business.

I urge the Commission to recognize the significant damage that could be done to the magazine industry if the CPI cap were removed and market-dominant rates were substantially increased. Periodicals may be a small portion of mail volume, but the class is very important in maintaining the value of the mail. Periodicals are wanted and eagerly awaited. Magazines are not the only mail customers look forward to receiving. Consumers no doubt love birthday cards and personal correspondence and presents. But magazines have been called the anchor of the mailbox for good reason. Magazines arrive at the request of, and anticipation by, the consumer. Magazines are invited guests into consumers' homes, via their mailbox. A dramatic falloff in Periodicals mail would not only cause the loss of many beloved titles, but also diminish the mail moment and the value of the mail.

**Exhibit 1**

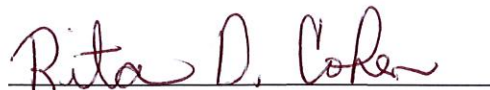
	<b>Periodicals</b>	<b>First-Class Mail</b>	<b>Standard Mail</b>	<b>TOTAL</b>
Volume	2,294,082,811	88,569,591	1,312,809,911	
Unit Contribution	- \$0.101	\$0.276	\$0.105	
Contribution	- \$232,660,393	\$24,487,023	\$137,335,617	- \$70,837,753

Note: Unit contributions based upon FY 2016 USPS data.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 17, 2017.



Rita D. Cohen

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**DECLARATION OF JERRY FAUST ON BEHALF OF TIME INC.**

1.     My name is Jerry Faust. I am VP-Print & Distribution, Time Inc. My business address is 225 Liberty Street, New York, New York, 10281. I am responsible for overseeing Time Inc. Production's central print purchasing, magazine distribution, postage payment and advertising production services as well as production operations for Time Inc. Content Solutions and MNI Targeted Media Inc. I have overall responsibility for Time Inc.'s postal operations and affairs initiatives. I am a member of the PostCom Board or Directors where I serve on the executive committee and act as a PostCom representative to the PMG's Mailers Technical Advisory Committee. I am also a member of MPA's postal committee.
2.     The core of Time Inc.'s business is periodicals. In 2016, Time Inc. spent over \$251MM in postage with the USPS. Although periodical mail constituted about 75% of the total postage spend, Time Inc. also spent over \$11MM on First Class Mail postage and over \$48MM on Standard (Marketing) Mail postage in 2016. Time Inc.'s FCM and Marketing Mail use is directly tied to the number and volume of periodicals it mails each year. Its use of other classes of mail, including Marketing Mail, FCM, Bound Printed Matter, Packages, and International mail supports Time Inc.'s core Periodicals business with respect to renewals, direct mail, bills, gift

incentives, and special publications. Time Inc. employs 4,500 individuals in the United States, 16% of whom (720 employees) work directly in mail related functions.

3. The CPI-U price cap for market dominant products at the class level is fundamental to the Postal Accountability and Enhancement Act of 2006 (PAEA) and is working. Use of the price cap provides predictability and stability of prices for mail users while allowing pricing flexibility for the Postal Service. The price cap has successfully incented Postal Service management to focus on reducing costs and increasing efficiency in a manner that was lacking with the prior cost-of-service pricing approach under PRA. The Postal Service recorded a positive controllable operating income in FY2014, 2015 and 2016 largely due to the cost reduction and efficiency improvements implemented under PAEA. The price cap is not the reason for the Postal Service's financial difficulties.

4. Prior to PAEA, Time Inc. dedicated substantial resources towards projecting and preparing for unpredictable postal increases. Time Inc. retained a dedicated postal lawyer to litigate rate increases under PRA. Unpredictable and highly volatile rate increases could lead to drastic decisions to mitigate unexpected and unbudgeted financial impacts. These actions have included reducing issue frequency, circulation, number of edit pages, physical dimensions, paper basis weight, and/or closing a title.

5. The class level, CPI-U price cap feature of PAEA has made rate increase more transparent and predictable. This has decreased the legal and administrative

resources Time Inc. needs to commit to postage rate changes and has allowed magazine titles to budget for postage cost increases in a more measured manner. Although postage price increases still impact the business, the individual magazines can better plan for the increases and manage their business based on known vs. potential costs since PAEA.

6. This decrease in legal and administrative costs has been extremely important for Time Inc. as the share of its costs consumed by postage has continued to rise. Even with moderate, annual postage rate increases under PAEA, postage cost's share of Time Inc. magazines' total, physical production costs increased from 24% in 2006 to 38% in 2015. Of the three, primary physical production costs (paper, print and postage), only postage continually increased during this period despite ongoing presort and drop ship optimization by Time Inc.

7. Prior to PAEA, the unit costs of Periodicals flats, as reported by the Postal Service's costing system, increased almost every year by more than inflation despite greater worksharing by mailers and increased postal automation, both of which were expected to reduce costs. Under PRA's cost-of-service pricing, the Postal Service was able to pass the ever increasing costs on to mailers in the form of higher Periodicals rates. As a result, Periodicals rates had increased much more than inflation, while at the same time mailers were incurring higher non-postal costs in order to make flats easier for the Postal Service to transport, handle and deliver. Under PAEA, the above inflation rate increases have stopped, the Postal Service has more effectively controlled costs and, since 2009, Periodical cost increases have

more or less stayed within the CPI-U limit. Nevertheless, Time Inc. believes there is more that the Postal Service can do to reduce costs for processing and delivering Periodical flats. For example, the Postal Service has the option to further incent carrier route presorted pieces to achieve more efficient and profitable mail in Periodicals.

8. As noted above, postage increases since 2006 have outstripped the cost increases for other inputs such as paper and print. In other words, Time Inc.'s suppliers of other inputs have been able to keep cost increases below the rate of inflation in response to financial pressures since that time. However, the one core cost that has increased annually during this period is postage. In 2006, postage represented 24% of Time Inc.'s total physical production cost. In 2011, postage was 29% of total production costs and in 2015 it was 38%.

9. Time Inc. has had to address a changing market and look for opportunities to reduce costs to stay competitive. Key revenue streams for Time Inc.'s print magazines – print advertising, newsstand copy sales, subscription circulation – have been declining since 2007. At the same time, Time Inc. has been negatively impacted by new postal rules and regulations. For instance, as a result of earlier Critical Entry Times ("CETs") established by the Postal Service, all four of Time Inc.'s Weekly magazines moved up their editorial close schedule to ensure deliveries were made to the USPS processing facilities prior to the earlier CETs implemented in both FSS and non-FSS zones and minimize the increase in post-weekend in-homes. Collapsing the editorial schedules has decreased the magazine's ability to

cover news and events throughout the week in a print format, impacting the value of the product. Despite the editorial close schedule changes, the earlier CETs still pushed delivery of our Weekly magazines to later in the week; for example, approximately 22% of Sports Illustrated subscribers receive their magazines one day later now than their prior delivery day.

10. The requirement of the 250 lb. FSS Scheme pallet significantly increased pallet charges invoiced by the printers for our Weekly magazines as well as causing us to incur extra postage.

11. As a result of these financial pressures, since 2007, Time Inc. has closed eight magazine titles, sold twelve magazine titles, reduced issue frequency for seven magazine titles and cut circulation for five magazine titles to manage costs in a market of declining magazine print advertising and circulation revenues. Staff reductions have been a routine occurrence at Time Inc. to help offset declines in print related revenues. In fact, Time Inc. has lowered its cost base every year from 2011 - 2015 through staff reductions and lower print and paper costs.

12. Without the price cap, the Postal Service would likely return to the practice under the PRA of simply passing cost increases on to the mailers. If the USPS were allowed to increase its market-dominant rates substantially faster than inflation, Time Inc. would pursue additional magazine closures, circulation cuts, issue frequency reductions, conversions to digital only, and further headcount reductions. We estimate a postage rate increase of 5% above CPI would result in a 14% reduction in the number of periodical pieces mailed by Time Inc. (approximately

97MM pieces/yr.); CPI +10% would result in a 39% reduction in total mailed pieces is estimated (approximately 272MM pieces/yr).

## VERIFICATION

I, Jerry Faust, declare under penalty of perjury that the foregoing is true and correct. Executed on March 17, 2017.

A handwritten signature in cursive script, reading "Jerry Faust", is written over a horizontal line.

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**DECLARATION OF CRAIG FINSTAD  
ON BEHALF OF AMERICAN LUNG ASSOCIATION**

I, Craig Finstad, declare as follows:

1. I am the Assistant Vice President, Direct Response, for the American Lung Association (“ALA”). The ALA is a charitable organization exempt from federal income tax under Internal Revenue Code Section 501(c)(3), and is headquartered in Chicago, IL. My business address is 1200 Hosford Street, Suite 101, Hudson, WI 54016.

2. I have worked for the ALA for over 34 years, and have served in my current position for over 13 years. As Assistant Vice President, Direct Response, I coordinate the ALA’s direct mail programs and monitor postage costs in an effort to maximize the organization’s net income and increase donor response. Use of direct mail is vital to our organization’s ability to disseminate important information and fulfill its charitable purpose.

3. I also serve as Treasurer and Executive Committee Member on the Board of Directors of the Alliance of Nonprofit Mailers (“ANM”). Through these roles with ALA and ANM, I have over 34 years of experience working in the nonprofit direct mail industry and advocating for the maintenance of affordable postage costs and high service standards.

4. Established in 1904, ALA is one of the oldest nonprofit organizations in the United States. The organization was founded to battle one of the most serious health threats of the time, tuberculosis. It was successful in this effort and over time broadened its mission and charitable programs to combat other threats to lung health, including asthma, chronic obstructive pulmonary disease, lung cancer, air pollution, and smoking. ALA is a Better Business Bureau (“BBB”) accredited charity and meets all twenty standards for charity accountability established by the BBB’s Wise Giving Alliance. It remains the leading national charitable organization supporting lung health today.

5. Since the launch of the Christmas Seals® campaign 110 years ago – the very first direct mail fundraiser – direct mail has been a crucial component of ALA’s work. Today, direct mail generates over twenty-five percent of ALA’s income from public donations and remains the single largest source of donation income to the charity. In 2016, ALA spent more than \$5 million on outgoing postage (primarily at nonprofit rates) and generated over \$600,000 in first class return postage.

6. Lung cancer is the number one killer of both men and women in the United States, and more than 32 million Americans are battling chronic lung disease. In support of its charitable mission to save lives by improving lung health and preventing lung disease, ALA looks to fund additional research into treatments and, ultimately, cures for this devastating disease that costs taxpayers billions of dollars in health care expenses annually.

7. Above-inflation increases in the postal rates charged for market dominant products would hamper ALA’s ability to fight lung disease. Because ALA relies on direct mail campaigns, higher rates of postage limit our reach and reduce the net revenue that

our organization can spend on critical programs and research funding. Indeed, even with CPI-capped rates of increase, weathering tough economic conditions while staying true to our charitable mission has been difficult.

8. For example, over the past ten years, the number of donations via direct mail received by ALA has decreased by more than sixty percent (from 3 million to 1.12 million), and ALA's net income from direct mail available to support its cause has declined from \$15.7 million to \$7.4 million (a decrease of 53 percent). During the same ten-year period, nonprofit postal rates have increased by 38.5% percent.

9. If the CPI cap were removed and the postal service were free to increase postal rates faster than inflation, it would reduce the American Lung Association's ability to raise significant funding using the mail to combat lung disease. Further rate increases would force ALA's Board of Directors and management to divert resources away from direct mail operations and attempt to replace that revenue stream through alternative channels, which would also result in fewer first class responses.

10. Switching to alternative solicitation channels would reduce our public outreach because ALA's donor base skews demographically toward the elderly, many of whom do not use email. Many of those in our donor base who do have an email address are unwilling to donate online with a credit card. In contrast, direct mail puts information directly into the hands of our supporters and allows them to maintain it for future reference. Our fundraising would suffer and limit the critical programs we offer to the public, to clean up the air we breathe and improve the health of all Americans, which ultimately harms our society.

12. Further declarant sayeth not.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 20, 2017.

A handwritten signature in black ink, reading "Craig Finstad". The signature is written in a cursive style with a large, looping initial "C" and a stylized "F".

Craig Finstad  
American Lung Association

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM	)	
FOR REGULATING RATES AND CLASSES	)	Docket No. RM2017-3
FOR MARKET DOMINANT PRODUCTS	)	

**DECLARATION OF SANDRA MIAO  
ON BEHALF OF NATIONAL WILDLIFE FEDERATION**

I, Sandra Miao, declare as follows:

1. I am the Director of Membership for the National Wildlife Federation ("NWF"). NWF is a charitable organization exempt from federal income tax under Internal Revenue Code Section 501(c)(3), and is headquartered in Reston, Virginia. My business address is 11100 Wildlife Center Drive, Reston, VA 20190.

2. I have served NWF as its Director of Membership for the past five years. As Director of Membership, I coordinate NWF's direct mail fundraising programs and monitor postage costs to maximize the organization's net income and increase donor response.

3. I also serve as a member of the board of directors of the Alliance of Nonprofit Mailers ("ANM"). I have over 30 years of experience working in the nonprofit direct mail industry and advocating for the maintenance of affordable postage costs and high service standards.

4. NWF's mission is to unite all Americans to ensure that wildlife thrive in a rapidly changing world. Since 1936, the NWF has joined with people across the country to share knowledge and resources in a common effort to protect wildlife, special places, and natural resources. Protecting these resources is a cause that has long united Americans from all walks of life and political stripes. All Americans, regardless of location, depend on clear air, clean water, and a healthy environment. NWF takes pride in defending those needs.

5. NWF's past and current efforts have involved saving wetlands, creating wilderness areas, and protecting wildlife habitats, encouraging children to be active outdoors, and finding solutions to the climate crisis.

6. NWF's wildlife preservation efforts include dealing with warming climate, protecting endangered species, containing the spread of invasive species, creating safe corridors for wildlife, keeping common species common with state wildlife action plans, restoring bison to the Great Plains and advancing red wolf recovery.

7. NWF works to protect, maintain and restore healthy habitats around waters, coasts and floodplains, gulf restoration, public lands, tribal lands, forest and farms. NWF advocates for federal and state policies that will improve wildlife conservation on hundreds of millions of acres of public, tribal and private lands, including thousands of miles of streams, rivers, lakes and coastlines. NWF also encourages Congress to appropriate adequate funds for natural resources and encourages federal agencies to include climate science in their wildlife conservation management plans. By supporting

wildlife conservation, including habitat protecting, NWF seeks to save thousands of species, protect biodiversity, and avoid expensive emergency recovery measures.

8. Connecting people with nature is an increasingly important mission for NWF. NWF connects Americans adults and children to the outdoors through Garden for Wildlife™, Eco-Schools USA environmental education initiative, Earth Tomorrow®, and other programs.

9. NWF is also committed to fighting climate change, the greatest current threat to American wildlife, wild places and communities. Failure to arrest global warming could cause breeding ground for ducks in the American heartland to dry up, moose in New England to be lost to parasites, western forests to burn more often, and Appalachian streams to become inhospitable to trout. NWF is working to reduce greenhouse emissions throughout the country by promoting a rapid transition to clean energy. NWF also works with farmers and ranchers to adopt agricultural practices that protect wildlife, reduce emissions, and store carbon.

10. Mail plays a vital role in NWF's mission. We rely on direct mail to raise money and awareness. NWF mails 36,000,000 pieces of direct mail annually, mostly at nonprofit Standard Mail rates. We circulate our publications, *Ranger Rick*®, *Ranger Rick Jr.*, *Cub*, and *National Wildlife Magazine* at Periodicals Mail rates. We also typically send several pieces of First-Class Mail in response to each donation received.

11. The latest economic downturn has been especially difficult for NWF. Between 2012 and 2016, NWF's overall revenues decreased each year by an average of

nearly five percent. Financial pressures have forced NWF to cut or limit staff, reduce program activities, and limit our publication volume.

12. Allowing the USPS to increase its market-dominant rates faster than inflation would increase NWF's fundraising costs and reduce the funds available for our programs. NWF would immediately be forced to reduce the quantity of mail for its fundraising appeals and renewals, magazines, and other important publications and switch to alternative channels of communication. This would greatly impair NWF's effectiveness: a large portion of our donors and target audience still prefer receiving print publications, which can depict nature and wildlife more vividly than, for example, telemarketing can. Increases in postage thus could impair the cleanliness, safety, and beauty of the outdoors and its wildlife for future generations. In the end, government spending to protect wildlife, public lands, and the environment would need to increase to offset the diminished effectiveness of NWF and other conservation organizations.

13. Further affiant sayeth not.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 6, 2017.



Sandra Miao

Natural Wildlife Federation

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM     )  
FOR REGULATING RATES AND CLASSES     )     Docket No. RM2017-3  
FOR MARKET DOMINANT PRODUCTS     )

**DECLARATION OF MICHAEL NADOL  
ON BEHALF OF  
ALLIANCE OF NONPROFIT MAILERS,  
ASSOCIATION FOR POSTAL COMMERCE, AND  
MPA—THE ASSOCIATION OF MAGAZINE MEDIA**

**(March 20, 2017)**

**I. Background and Assignment**

I, Michael Nadol, am President of PFM Group Consulting, LLC and a shareholder and Managing Director in the PFM Group of affiliated companies, which provide financial and management advisory services to public sector entities nationwide. In over 17 years with the PFM Group, I have advised state and local governments and federal agencies on a broad range of management and budget issues, including recovery from fiscal distress, multi-year financial planning, retiree benefits, and public employee compensation. My clients have included a majority of the ten largest U.S. cities by population, as well as the states of New York, Pennsylvania, Kentucky, Tennessee, Washington, New Jersey, and Delaware. With PFM, I have testified as an expert witness regarding financial management and/or compensation comparability in Federal District

Court, before two Presidential Emergency Boards convened under the Railway Labor Act, and in public employee interest arbitration proceedings in nine states.

Prior to joining PFM, I worked in the public and nonprofit sectors for 14 years, with eight of those years spent in a range of management and budget positions with the City of Philadelphia, Pennsylvania, including Director of Finance and Director of Labor Relations. I have also served on the faculty of the University of Pennsylvania's master of public administration program since 1997, and am an appointed adviser to the Government Finance Officers Association national committee on Governmental Budgeting and Fiscal Policy. I hold a bachelor's degree, summa cum laude, from Yale University and a master's degree in governmental administration from the University of Pennsylvania, Fels Institute of Government.

A more detailed summary of my training and experience is provided in Exhibit A.

For this report, I was engaged by MPA - Association of Magazine Media to provide research, analysis, and development of an expert report for the Postal Regulatory Commission 10-Year Review of System of Regulating Rates. For this report, I was asked to focus specifically on evaluating the condition of key components of the United States Postal Service ("USPS" or "Postal Service") balance sheet, particularly as related to retiree benefits, and to assess major drivers of the USPS operating budget, notably employee compensation.

To conduct this review, I evaluated prior reports and testimony from the USPS itself, U.S. Government Accountability Office ("GAO"), and the USPS Office of Inspector General ("OIG"), and conducted up-to-date original analysis based on data from the U.S. Bureau of Labor Statistics ("BLS"), major credit rating agencies, and a broad range of primarily governmental sources. For some analysis, professional staff under my direction assisted in data collection, review, calculations, and quality assurance. In all cases, I have closely reviewed such supporting work directly. The information on which I have relied is footnoted throughout this report, with key datasets and calculations provided in an accompanying Library reference.

## **II. Overview of Findings**

My review and analysis indicates that the USPS is significantly better positioned than most other large, public sector organizations to manage the long-term requirements of funding retiree benefit liabilities. With comparatively strong funded levels, the Postal Service can continue to strengthen this component of its balance sheet over a multi-decade period with no near-term – or even intermediate-term – budget risk.

At the same time, the USPS also holds significant opportunities to improve its future operating budgets by further restructuring its approach to personnel costs – the single largest driver of overall Postal Service operating expenditures. As long acknowledged, and confirmed through updated analysis within this report, the USPS provides its employees with a substantial total compensation premium above what is typically provided for comparable levels of work in the private sector of the economy. With multiple tools available to contain and even reduce these costs going forward, the Postal Service has ample opportunity to manage against and within revenue restraints.

### Balance Sheet and Retiree Benefit Liabilities

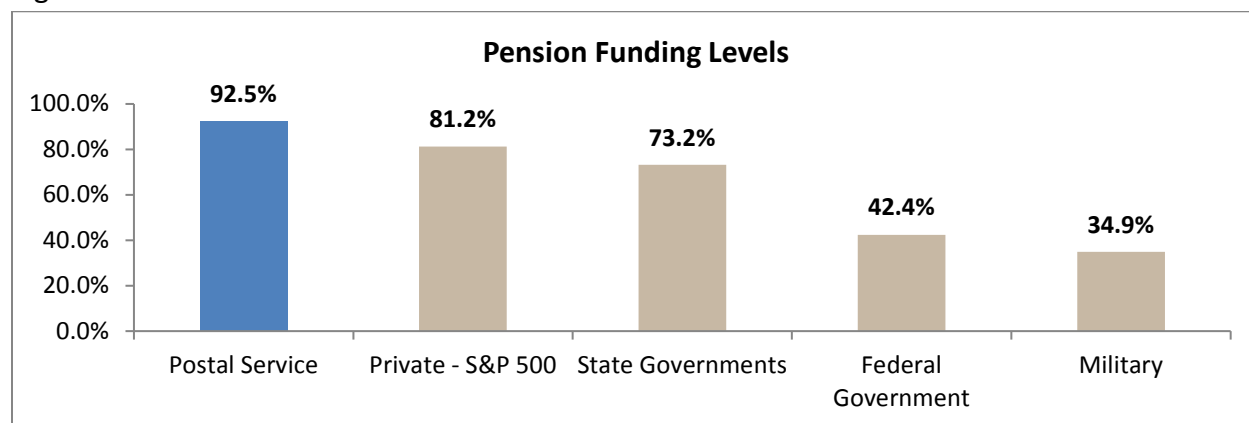
The USPS has regularly cited balance sheet concerns, associated primarily with retiree benefit liabilities, as a significant challenge to its financial health. These liabilities have been addressed in numerous reports by the OIG and GAO, and statutory mandates for retiree healthcare prefunding have been the primary driver of recent USPS operating net losses and non-payments characterized as defaults.

While a sound funding approach for long-term liabilities is indeed important, a more comprehensive evaluation of the underlying USPS balance sheet condition leads to a very different conclusion regarding the current Postal Service fiscal condition than the recent language of net losses and defaults would connote. In particular, it is critical to recognize that the statutorily established targets for USPS retiree healthcare prefunding that drove recent operating

losses were not actuarially determined, but were instead substantially frontloaded and inconsistent with mainstream retiree healthcare funding practices.

In fact, when viewed on a comparative basis, the USPS is currently better positioned than most other entities – both public and private – with regard to its retiree benefit obligations. Looking at reported actuarial funded levels as of FY2014 (the most recent year for which comparative data are broadly available), the Postal Service’s 92.5% pension funding level was in far stronger condition than most state and local government plans, as well as the federal government overall, and also well above the private sector standards established under the Pension Protection Act of 2006 for determining a plan to be “at risk” or “endangered.”<sup>1</sup> Likewise, for retiree healthcare, while the USPS is funded at a lower actuarial level than for pensions at approximately 50%, most private employers, the federal government, and many state and local governments have yet to prefund this benefit at all.

Figure 1<sup>2</sup>



<sup>1</sup> Congressional Research Service, “Summary of the Pension Protection Act of 2006,” October 23, 2006.

<sup>2</sup> Sources: USPS Report Form 10-K, Civil Service Retirement and Disability Fund 2015 Annual Report, U.S. Military Retirement Fund Audited Financial Report 2015, Standard & Poor’s RatingsDirect: U.S. State Pensions: Weak Market Returns Will Contribute To Rise In Expense, September 12, 2016, Standard & Poor’s RatingsDirect: Pensions and OPEBs are Heading Into The Sunset, A Half-Trillion Dollars Short, June 17, 2015.

Further, these USPS nominal funded levels are actuarially calculated based on more conservative assumptions than used by most comparable plans, driven by federal constraints on investment practices associated with lower investment risk. For example, the aggregate Postal Service retirement plans, if estimated based on a 7.0% investment return assumption instead of the current 5.25% for pensions and 3.9% for retiree healthcare, would have total assets in excess of total liabilities.

Reasonable, partial steps forward have been proposed by USPS management and other stakeholders to mitigate the ongoing financial burden of retiree benefit liabilities. Postal Service proposals and pending federal legislation – to require Medicare participation for USPS retirees (given that the Postal Service fully contributes into the Medicare program), to calculate USPS liabilities using Postal Service-specific assumptions rather than federal government-wide demographics, and to allow for a broader range of investment options – could substantially reduce, if not eliminate, both the current unfunded liabilities and the budget pressure resulting in operating net losses.

As such opportunities are pursued, it is important to recognize that the funding of retiree benefit liabilities is a long-term challenge for most major public employers and for those corporations still offering defined benefits at all. This challenge is generally expected to take decades to address and correct under standard funding approaches. At the USPS, with substantially better funding levels than most other public and private employers, there is similarly no immediate solvency concern – even with no reforms. As of September 30 2016, the USPS had a total of nearly \$338.4 billion in prefunding set aside for pension and retiree healthcare liabilities. At this level of funding, estimates detailed later within this report project that the Postal Service could make *no* further contributions into these accounts for the next ten years, adopt no further benefit or actuarial reforms, fully pay all current obligations out of these funds, and still have \$243.3 billion in remaining assets available as of September 30, 2027.

Given the available and viable options to reduce these obligations, viewed in tandem with the very long-term nature of these challenges and the Postal Service's comparatively strong progress toward addressing them, the USPS should focus first on maximizing its opportunities to lower the size of these liabilities rather than prematurely increasing and destabilizing its rate structure to fund what is currently projected. There is no immediate "crisis," the Postal Service is on a path toward incrementally resolving the multi-decade challenge that does exist, and achievable liability reduction measures could dramatically reduce these long-term funding needs to obviate *any* need for increased funding well before these liabilities generate true, near-term solvency pressure.

Looking at the USPS balance sheet beyond retiree liabilities, the Postal Service's real estate assets have also been estimated to hold substantially greater value than accounting treatments of these assets would suggest. When viewed from a fair market value perspective, these assets provide additional strength to the USPS balance sheet, reflecting greater financial health and flexibility than cited book value indicates – in turn, providing a substantial and under-recognized safety net against any long-term industry and business risks faced by the USPS.

Finally, with regard to balance sheet considerations, it may be noted that limitations of the current USPS financial statements almost certainly understate the strength of the Postal Service position in the two respects noted above that have yet to be accurately quantified. Again, USPS retiree benefit levels are valued based on U.S. government-wide economic and demographic assumptions that the Postal Service estimates to significantly overstate its liabilities. Second, the fair market value of the USPS real estate assets has only been estimated using broad, 2012 trend factors. Before significantly increasing funding to address perceived balance sheet concerns, it would be beneficial to first more accurately assess this position, along with pursuing available liability reduction opportunities.

## Operating Costs and the Postal Service Compensation Premium

Postal Service operations are labor-intensive, and employee wages and benefits are the single largest driver of USPS operating costs. According to the 2016 Report on Form 10-K of the USPS, total compensation costs represented 78.6% of total operating expenses for FY2016 - more than \$60 billion and over three-quarters of all spending.<sup>3</sup> The simple equation that drives such overall workforce operating costs is the average cost per employee multiplied by the total number of employees. As further detailed in subsequent sections of this report, the USPS has significant opportunities to manage cost pressures from both of these factors to work within its revenue framework going forward.

With regard to cost per employee, the USPS continues to provide a substantial wage and benefit compensation premium well above the policy directive of the Postal Reorganization Act of 1970, 39 U.S.C. § 1003(a) (“PRA”), that the Postal Service shall:

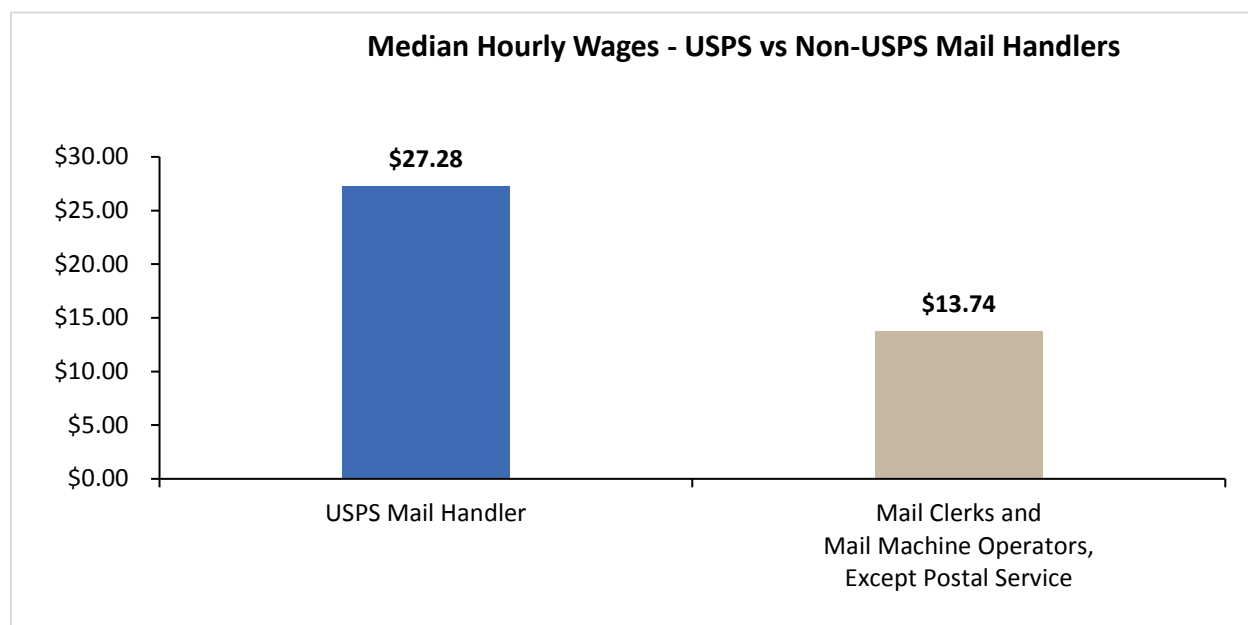
*“...maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy.”*

As further detailed later in this report, using BLS Occupational Employment Statistics (“OES”) data, I compared average Postal Service compensation across major USPS occupations to related occupations in the broader private sector. This analysis indicated a substantial wage premium for Postal Service employees – as shown in Figure 2 below comparing median hourly wages for Postal Service and non-USPS mail handlers as of May 2015. Further, parallel comparisons of USPS benefits relative to private sector norms identified additional advantages in the Postal Service overall compensation structure.

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<sup>3</sup> 2016 USPS Report on Form 10-K, page 12.

Figure 2



In turn, the existence of this substantial compensation premium provides the opportunity for future moderation of the largest Postal Service cost category, and even substantial reductions as needed, without adversely impacting the ability to recruit and retain a quality workforce.

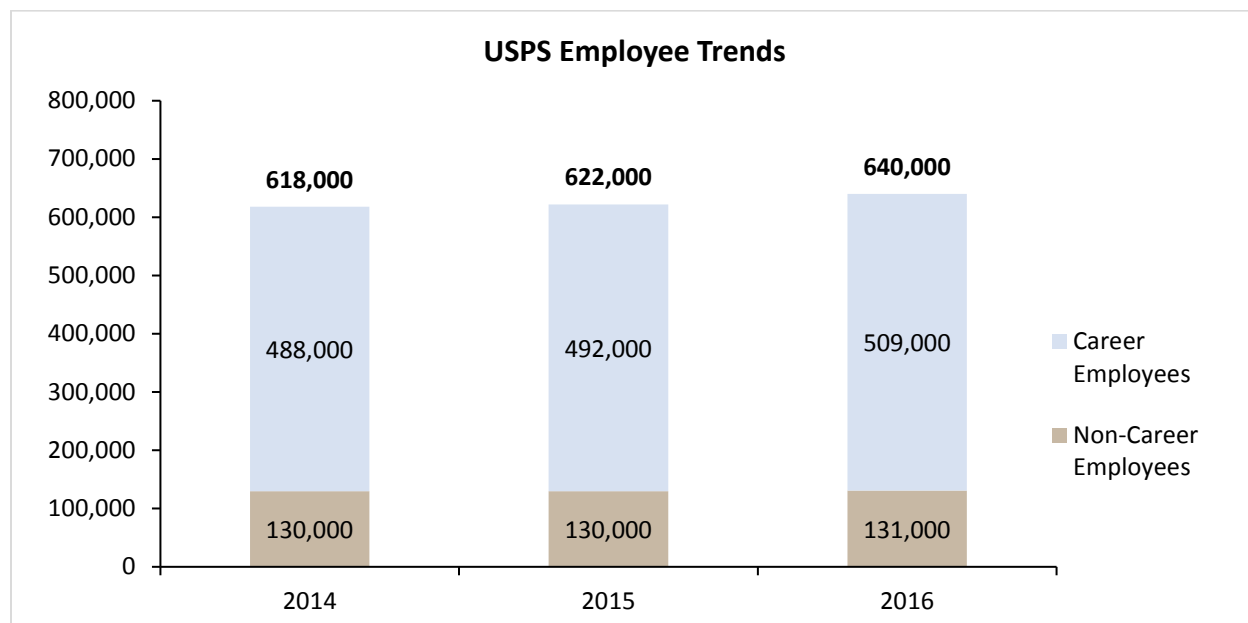
Under the existing rate system in place since the passage of the Postal Accountability and Enhancement Act (“PAEA”), the Postal Service has achieved some savings through measures such as reduction in the size of its overall workforce, and expanded use of flexible, non-career (Tier 2) employees paid at levels with less of a premium above comparable private sector pay rates. Although higher-paid, incumbent career (Tier 1) employees have experienced little or no cost containment in compensation, the pay scales for Tier 2 employees newly hired since 2010-2013 have also been moderately lowered.

Across these various savings approaches, however, the Postal Service’s actions have been limited and partial, and have slowed – or even reversed direction – within the past several years. Going forward, remaining opportunities for cost reduction and containment continue to hold significant untapped potential.

As of March 2017, none of the four major USPS unions have a collective bargaining agreement extending beyond 2019. Accordingly, the great majority of the time period to be covered under the next ten-year rate system will take place under collective bargaining agreements yet to be negotiated. These agreements determine much of the existing Postal Service compensation structure. Specific opportunities prospectively include:

- Contain future growth in compensation for the long-term, Tier 1 career service employees who benefit from the largest wage and benefit premium. As will be further detailed, this large cohort has continued to experience pay schedule increases in excess of the growth in consumer prices and federal pay over the past decade of contract periods.
- Further restructure the compensation for new career service hires to work under a more affordable, permanent second tier. Despite some adjustments for new Tier 1 workers hired since 2010-2013, all career service compensation remains well above market levels. Such permanent two-tier structures are a common approach for industries adjusting to changing market and economic realities.
- Expand the use of Tier 2 non-career service employment to provide greater workforce flexibility and cost relief. Current Tier 2 pay rates are comparatively well aligned with the broader labor market, and could form the basis for both permanent and temporary second tiers going forward. For example, Tier 2 Mail Handlers earned between \$14.37 and \$15.15 per hour in May 2015, much more closely aligned with the \$13.74 median hourly wage for comparable workers outside of the Postal Service previously referenced than the \$27.28 median wage for Tier 1 USPS Mail Handlers. In practice, however, the percentage of Tier 2 employees in the overall Postal Service workforce actually *declined* from 2014 to 2016. As shown in Figure 3 below, of 22,000 net positions added from 2014 to 2016, 21,000 (95.5%) were in Tier 1 career jobs.

Figure 3



- Address the high cost of benefits. While some of the generous USPS healthcare and retirement benefits are required under current law, the Postal Service can continue to collectively bargain limitations on its employer share of the contributions toward healthcare premiums. Although partial progress has been made in this direction, the Postal Service still provides a more generous subsidy than the rest of the federal government contributes toward its own employees in the same system. In addition, the Postal Service collective bargaining agreements continue to feature paid leave benefits well in excess of private sector norms, which drive higher staffing levels and costs.
- With regard to the total number of USPS employees, headcount can also be adjusted as needed to help manage changes in demand, as done from 2006 to 2014 under the existing rate system. Overall, however, not only have USPS position levels actually increased since 2014, but the GAO has also recently testified that the Postal Service “*has no current plans to initiate new major initiatives to achieve cost savings in its operations.*”<sup>4</sup> While it is

<sup>4</sup> GAO-17-404T, “USPS Key Considerations for Restoring Fiscal Sustainability,” February 17, 2017, page 10.

concerning that further progress toward increased efficiency and productivity is not underway, this set of circumstances also presents an opportunity going forward. If the USPS is challenged to drive toward greater economies and provided economic incentives to do so, the staffing reductions that can be advanced through management, technology, and/or service adjustments would all generate savings relative to the Postal Service's current projections.

In total, reining in the general Postal Service compensation premium could make available billions of dollars in additional compensation capacity that could be redeployed to help address other needs – whether for capital investment, rate relief, and/or to fund any long-term costs for retiree benefit obligations that cannot be otherwise resolved.

Finally, to provide a framework for advancing the above opportunities in ways consistent with the USPS statutory mandate to achieve private sector compensation comparability, it is important that the Postal Service not be handed a "blank check" for funding continued wage and benefit premiums and career staffing increases. While the achievement of workforce cost containment over the past ten years has only been partial, what progress has been made has occurred while subject to pricing limitations that provide some meaningful counterbalance in collective bargaining and interest arbitration. With retention of a reasonable rate cap, the USPS and its employee representatives will have a better framework and incentives in place to bargain toward compensation and benefits more consistent with the PRA policy directives for private sector comparability. Absent any such counterweight, however, the incentives for labor cost moderation will be substantially eroded.

Each of these considerations is addressed in greater detail in the sections that follow.

### **III. Current Postal Service Pension and Retiree Benefit Liabilities are Comparatively Well Funded**

#### Pensions

By any industry standard, the financial condition of USPS pensions is comparatively strong, as illustrated in Figure 1 within the “Overview of Findings” section of this report. As of September 30, 2014 (FY2014), the most recent date for which comparative information across a wide range of plans elsewhere is available, the funded level of the Postal Service component of the Civil Service Retirement System (“CSRS”) was 90.4% and the Postal Service component of the Federal Employees Retirement System (“FERS”) was funded at 96.6%. In the aggregate, the USPS pensions were nearly 92.5% funded.

This USPS funded ratio was higher than the funded level of the rest of the CSRS and FERS plans, the United States military plan, and the averages for all state government and S&P 500 plans, as further detailed below:

- In the federal CSRS program,<sup>5</sup> the overall FY2014 funded level was 31.0%, inclusive of USPS participation. Without the Postal Service component, the FY2014 funding level was only 17.6%. In the FERS program, the overall funded ratio was 91.2%, and was 90.0% without USPS participation. In the aggregate, these two major federal pension programs were 51.6% funded overall, and only 42.4% funded without the Postal Service’s participation.
- The U.S. Military Retirement Fund reported just a 34.9% funded ratio for FY2014.<sup>6</sup>

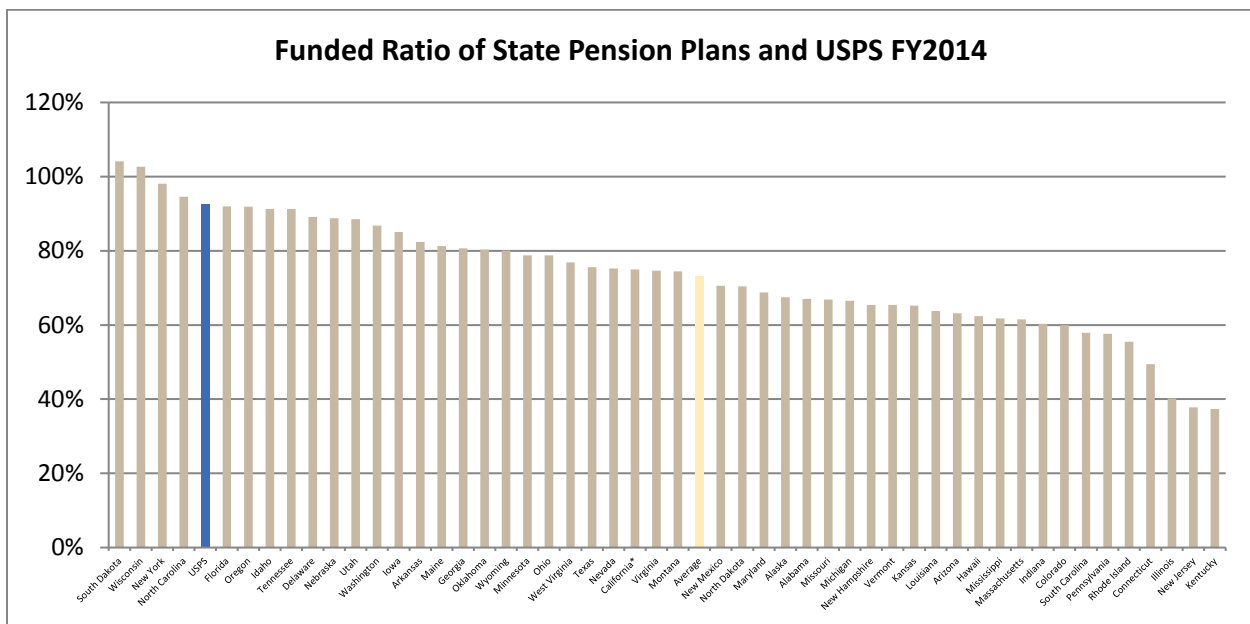
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<sup>5</sup> Table 1A, page 28, Civil Service Retirement and Disability Fund Annual Report, FY15; Statement of Postmaster General and CEO Megan J Brennan before the House Oversight and Government Reform Committee Hearing “Accomplishing Postal Reform in the 115<sup>th</sup> Congress – H.R. 756, the Postal Service Reform Act of 2017,” February 7, 2017.

<sup>6</sup> U.S. Military Retirement Fund Audited Financial Report 2015, page 17.

- Among state and local governments, the funded ratio for the Public Plan dataset consisting of large local plans and all state plans was 74.1% in FY2014.<sup>7</sup> The average funded ratio of the proportionate liability of state governments specifically was 73.2%.<sup>8</sup> As shown in Figure 4, the USPS funded ratio was higher than that of 46 states in FY2014, even though the Postal Service uses more conservative actuarial assumptions, as further outlined in Section IV of this report.

Figure 4



Credit rating agencies analyzing the state and local sector consider a broad range of factors regarding pension funding in their evaluations, including the reasonableness of actuarial assumptions, funding discipline, and funding capacity. In the context of this broader framework, Standard & Poor's has cited the following general standards for categorizing state government Pension Funded Ratios:<sup>9</sup>

<sup>7</sup> Center for Retirement Research, "State and Local Pension Brief 50, The Funding of State and Local Pensions: 2015-2020," June 2016.

<sup>8</sup> Standard & Poor's RatingsDirect: "U.S. State Pensions: Weak Market Returns Will Contribute To Rise In Expense," September 12, 2016.

<sup>9</sup> S&P Global Ratings, "U.S. State Ratings Methodology," October 17, 2016, page 21.

Three-Year Average Pension Funded Ratio	
90% or above	Strong
80%-90%	Good
60%-80%	Relatively low
60% or below	Weak

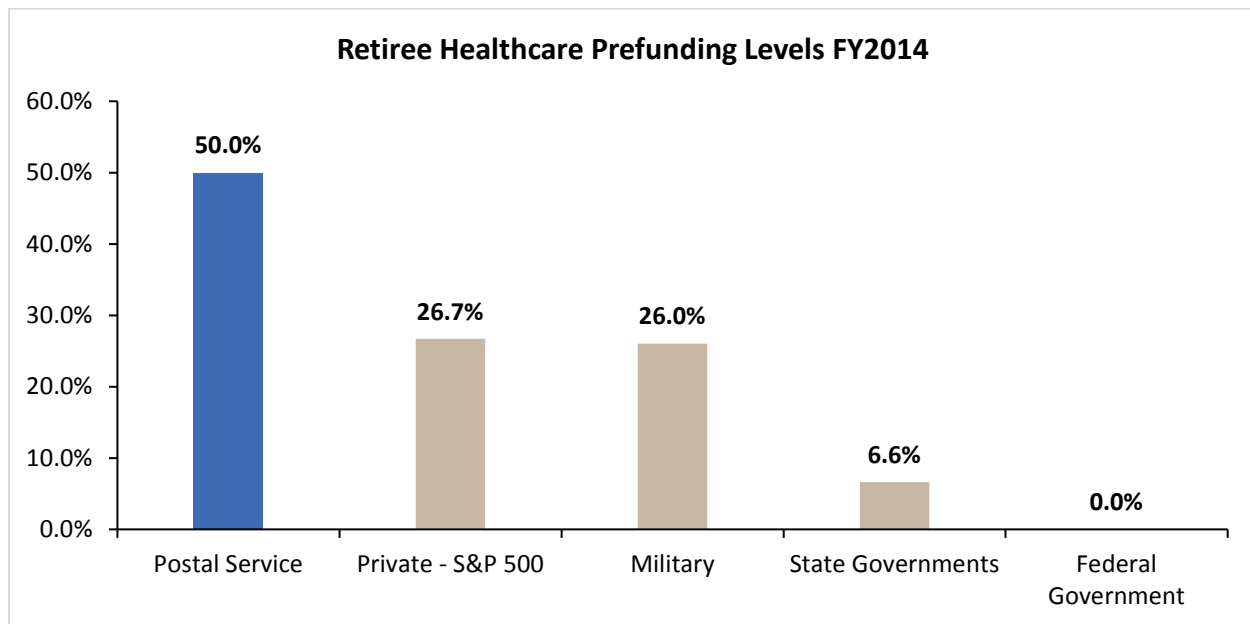
- In the private sector, 329 of the S&P 500 companies had defined benefit pension plan liabilities in FY2014. The overall funded ratio for these plans was 81.2%. As governmental plans, the federal CSRS and FERS are not subject to the rules and regulations of the Pension Protection Act of 2006. For the private sector, this legislation established standards pursuant to which plans are subject to more stringent requirements for plan administration. In conjunction with such requirements, the general threshold for a single-employer plan to be considered “at-risk” and for a multi-employer plan to be categorized as “endangered” would be to fall below an 80% funded level.

The aggregate CSRS and FERS funded ratio of 92.5% for FY2014 was used above primarily because that is the most recent year for which comparative information is broadly available. More recent financial statements report that this ratio has improved to 93.2% as of FY2015 and is estimated to stay consistent at 93.1% in FY2016. While full funding remains an appropriate long-term goal, the Postal Service continues to be exceptionally well-positioned along this path.

#### Retiree Healthcare

The Postal Service has also prefunded its retiree healthcare liabilities at a much higher level than the federal government, most state and local governments, and those major private corporations that still offer such benefits, as summarized in Figure 5:

Figure 5



- The federal government has not pre-funded any retiree healthcare obligations for civilian workers.<sup>10</sup>
- The Department of Defense has funded more than half of the liability for Medicare-eligible retirees, but has not funded any retiree healthcare obligations for pre-Medicare eligible retirees. The overall funded ratio for its plans was 26.0% for FY2014.<sup>11</sup>
- A majority of 56% of the 264 S&P 500 companies that still offered post-employment medical benefits in FY2014 had not pre-funded any obligations. In the aggregate, these 264 companies had a 26.7% funded level.<sup>12</sup> Across the private sector, there is no

<sup>10</sup> Statement of Postmaster General and CEO Megan J Brennan before the House Oversight and Government Reform Committee Hearing "Accomplishing Postal Reform in the 115<sup>th</sup> Congress – H.R. 756, the Postal Service Reform Act of 2017," February 7, 2017; Financial Report of the U.S. Government, 2014.

<sup>11</sup> U.S. Department of Defense, Agency Financial Report, Fiscal Year 2015, page 88.

<sup>12</sup> Standard & Poor's RatingsDirect: Pensions and OPEBs are Heading into the Sunset, A Half-Trillion Dollars Short, June 17, 2015.

equivalent statute to the Public Protection Act of 2006 addressing retiree healthcare liabilities or funding requirements.

- The average and median funded level for state governments was also 0% in FY14 - the typical state government had not pre-funded any liabilities. In aggregate, state governments had a 6.6% funded level for retiree healthcare in FY2014. Similarly, a review of state and local retiree healthcare prefunding using FY2013 data by the Center for Retirement Research at Boston College that included roughly 750 local government and school district entities indicated an aggregate nation-wide funded level of 7% for those entities and the 50 states.<sup>13</sup>

The USPS retiree healthcare funded ratio of 50.0% for FY2014 was primarily used above because that is the most recent year for which comparative information is broadly available. More recent financial statements report that this ratio dipped to 47.9% as of FY2015 but is estimated to improve to 49.9% in FY2016 based on continued asset growth and a \$1.2 billion reduction in the estimated liability. Although full funding remains an appropriate long-term goal, the Postal Service, again, continues to be far better funded than most public employers along this path.

While state and local governments have a relatively long tradition of prefunding pensions actuarially, the vast majority of state and local governments have viewed and funded retiree healthcare benefits on a pay-as-you-go basis until much more recently. In 2004, Governmental Accounting Standards Board (GASB) Statement 45 was issued requiring the reporting of Other Post-Employment Benefit (“OPEB”) plans on an actuarial basis. While many governments continue to use a pay-as-you-go approach or prefund at far below actuarially determined levels, GASB 45 did change awareness of these liabilities. In turn, this has led to the establishment of more dedicated trusts for pre-funding the benefit, as well as increased long-term planning to

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<sup>13</sup> Center for Retirement Research, “How Big a Burden Are State and Local OPEB Benefits?, State and Local Project Brief 48,” March 2016, page 4.

address (and, in many cases, reduce) the benefit structures.<sup>14</sup> Nonetheless, this relatively recent increase in focus on retiree healthcare means that full actuarial funding remains a long-term, multi-decade challenge for most state and local governments providing such benefits.

In this context – within which most comparable organizations are not yet even making full actuarial contributions toward retiree healthcare obligations – the PAEA required a fixed schedule of USPS annual contributions into the Postal Service Retiree Health Benefits Fund (PSRHBF) from FY2007 through FY2016 that was actually substantially greater than an actuarially determined approach.<sup>15</sup> In several GAO reports, these amounts have been described as “significantly frontloaded.”<sup>16</sup> Further, through FY2016, the PAEA schedule also required the USPS to contribute the full prefunding contribution *and* to continue to pay the cost of the benefits separately out of operations. Starting in FY2017, the USPS can now pay current retirees from the PSRHBF, such that the net fiscal impact on the operating budget is reduced by the pay-as-you-go obligations – an approach much more consistent with standard practice for other public and private sector retirement plans.

Absent these extraordinary retiree healthcare funding requirements in place through FY2016, the USPS would not have recorded the net losses from operations shown in recent years, and would not be reporting a \$33.9 billion liability associated with “defaulted” payments. In other words, using the same retiree healthcare funding approaches adopted by the federal government generally, as well as by most state and local governments, the Postal Service “financial crisis” would substantially fade away.

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<sup>14</sup> Center for State and Local Government Excellence, “Prefunding Other Post-Employment Benefits in State and Local Government,” September 2009; National Association of State Retirement Administrators, “Spotlight on Retiree Health Care Benefits for State and Local Employees in 2014,” December 2014.

<sup>15</sup> PL 109-435, Postal Accountability and Enhancement Act, December 20, 2006.

<sup>16</sup> GAO-17-404T, “USPS Key Considerations for Restoring Fiscal Sustainability,” February 7, 2017; GAO-13-112, “USPS Status, Financial Outlook, and Alternative Approaches to Fund Retiree Health Benefits,” December 2012.

Longer term, there are, of course, worthwhile benefits to prefunding retiree healthcare under a sound funding policy and as part of a broader total compensation strategy. Such an approach can help to fully and appropriately address the cost of such liabilities over time, more equitably allocate costs across generations, and better position an organization financially for the decades ahead. This long-term challenge, however, is distinct from an immediate crisis – and this goal can be achieved without a massive increase in revenue requirements.

#### IV. Nominal USPS Funded Ratios are Based on Conservative Assumptions and Practices

In addition to the relative strength of Postal Service retiree benefit funding when funded ratios are compared on a nominal basis, it is important to note that retirement plans report such ratios based on varying actuarial assumptions that can impact the scale of the calculated liability and funded status. As noted in the most recent Public Fund Survey<sup>17</sup> conducted by the National Association of State Retirement Administrators:

*Of all actuarial assumptions, a public pension plan's investment return assumption has the greatest effect on the projected long-term cost of the plan. This is because over time, a majority of revenues of a typical public pension fund come from investment earnings. Even a small change in a plan's investment return assumption can impose a disproportionate impact on a plan's funding level and cost.*

In this regard, the assumed rates of investment return and associated discount rates applied to liabilities for the USPS, civilian Federal Government, and Military plans are all significantly lower than those used for almost all state and local pensions. This difference increases the reported size of the calculated USPS unfunded liability relative to these non-federal plans.

Table 1 <sup>18</sup>	Discount Rate	Investment Assumption
Postal Service	5.25%	5.25%
Federal Government	5.25%	5.25%
Military	5.50%	5.50%
State Governments	7.69%	7.69%
Private - S&P 500	3.92%	7.00%

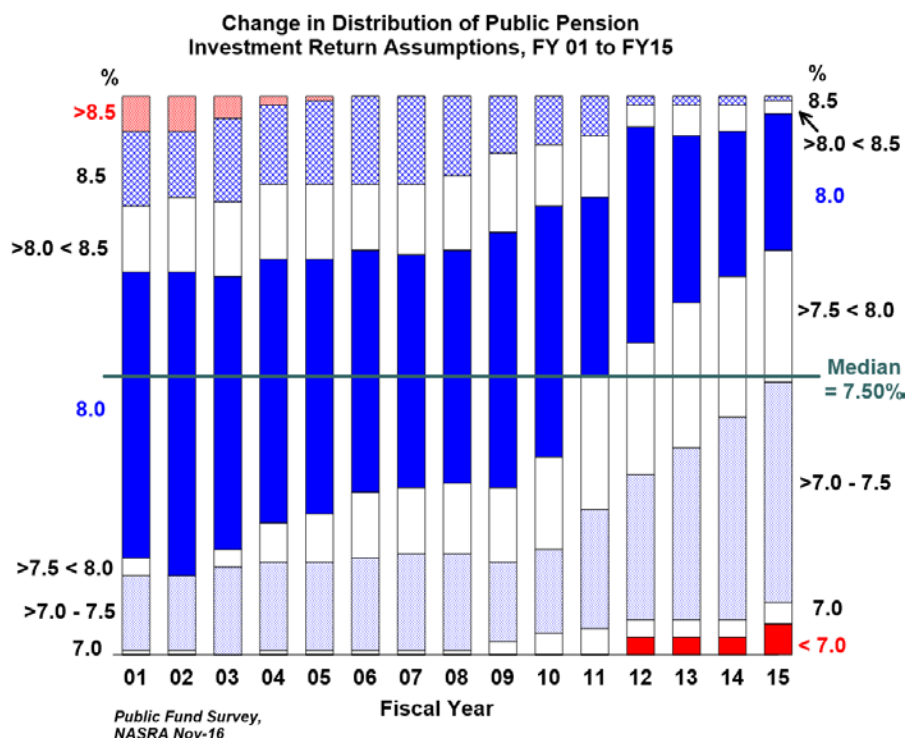
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<sup>17</sup> National Association of State Retirement Administrators, "Public Fund Survey, Summary of Findings for FY2015," December 2016.

<sup>18</sup> Sources: USPS Report on Form 10-K, Civil Service Retirement and Disability Fund 2015 Annual Report, U.S. Military Retirement Fund Audited Financial Report 2015, NASRA Issue Brief: Public Pension Plan Investment Return Assumptions, 2015, Standard & Poor's RatingsDirect: Pensions and OPEBs are Heading Into The Sunset, A Half-Trillion Dollars Short, June 17, 2015.

Figure 6 below, drawn directly from the November 2016 Public Fund Survey summary report, further illustrates the range of investment return assumptions across the full Survey dataset for FY2015. This Survey contains data on public retirement systems estimated to comprise approximately 85% percent of the state and local government retirement system community, compiled primarily by the Center for Retirement Research at Boston College, based largely on annual financial reports. As may be noted, there has been a clear trend toward more conservative investment return assumptions in the recent economic environment, however, the significant majority of systems continue to assume 7.0% or more for their returns.

Figure 6



One of the primary reasons for the lower investment return assumptions in the federal-related plans is that such plans are generally more restricted in their investment options. This dampens the potential USPS investment returns relative to all other public and private pension plans. As a result, the lower projected returns increase the reported size of the unfunded liability relative to state and local pension plans.

As detailed in the subsequent Section V of this report, a modification of these restrictions could potentially achieve greater long-term returns and result in a lower reported liability. From the perspective of mainstream practice across the state and local government sector, the federal investment constraints are extraordinary – and it is remarkable that the Postal Service has been able to achieve the comparatively high funded levels it has reached despite such limited investment options. Viewed in household terms, this would be akin to investing all of one’s 401(k) retirement assets in a money market account.

At the same time, it may also be noted that, because the current USPS and federal approach carries less investment risk than typical state and local plans, the likelihood of meeting reported actuarial assumptions is higher. In turn, this implies that the USPS faces less risk of future shortfalls emerging based on actual investment returns falling short of plan assumptions.

To further illustrate the impact of these varying investment return assumptions, we calculated the estimated<sup>19</sup> USPS funded ratios assuming discount rates of 7.0%, consistent with the average assumption for S&P 500 plans in FY2014, and at the comparatively conservative end of the range for state and local government pension plans.

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<sup>19</sup> For this analysis, we used a methodology consistent with that used by the credit rating agency, Moody’s Investors Service, for normalizing liability estimates across plans. Moody’s Investors Service, Cross Sector Rating Methodology, “Adjustments to US State and Local Government Reported Pension Data,” April 17, 2013. An actuarial analysis would reflect the unique benefit structure and demographics that affect the time-weighted profile, or duration, of future benefit payment liabilities. Because such durations are not generally reported, Moody’s uses a common assumption of 13 years, which is based on durations calculated from a sample of public plans. In turn, this duration assumption is used to implement the discount rate adjustment. A plan’s reported accrued liability is projected forward for 13 years at the plan’s discount rate, then discounted back at the high-grade bond index rate. For our adjustments to Postal Service data, we similarly assumed a 13 year duration, projected the liability forward at the plan assumed rates, and discounted back at 7.0%.

With a 7% discount rate assumption, as shown in Table 2, the USPS plans would be 114.6% funded. Similarly, as shown in Table 3, the PSRHBF funded ratio would also improve under higher discount rate assumptions, rising to 73.1% with a 7.0% rate.

Table 2

<b>Federal Pension Plans - USPS Share - September 30, 2014<sup>(1)</sup></b>			
<b>5.25% Discount Rate</b>			
	<b>CSFRS</b>	<b>FERS</b>	<b>Total</b>
Accrued Actuarial Liability	201.5	104.5	306.0
Assets (at Par Value)	182.1	100.9	283.0
Unfunded Actuarial Liability	19.4	3.6	23.0
Funded Ratio (Calculated)	90.4%	96.6%	92.5%
<b>7.00% Discount Rate</b>			
	<b>CSFRS</b>	<b>FERS</b>	<b>Total</b>
Accrued Actuarial Liability	162.6	84.3	247.0
Assets (at Par Value)	182.1	100.9	283.0
Unfunded Actuarial Liability	-19.5	-16.6	-36.0
Funded Ratio (Calculated)	112.0%	119.6%	114.6%

(1) Units in billions.

Table 3

<b>PSRHBF - September 30, 2016<sup>(1)</sup></b>	
<b>3.90% Discount Rate</b>	
	<b>PSRHBF</b>
Accrued Actuarial Liability	104.0
Assets (at Par Value)	51.9
Unfunded Actuarial Liability	19.4
Funded Ratio (Calculated)	49.9%
<b>7.00% Discount Rate</b>	
	<b>PSRHBF</b>
Accrued Actuarial Liability	71.0
Assets (at Par Value)	51.9
Unfunded Actuarial Liability	19.1
Funded Ratio (Calculated)	73.1%

(1) Units in billions.

In the aggregate, with a 7.0% discount rate, the reported overfunding in the pension plans would exceed the remaining retiree healthcare liability, such that the total assets of nearly \$335 billion across all three plans would exceed the combined actuarial liability of \$318 billion – for a funded ratio above 100%.

In addition to low investment return and discount rate assumptions, Postal Service retirement system actuarial reports and funding requirements are also based on salary growth and demographic assumptions developed by the federal Office of Personnel Management (“OPM”) using government-wide data, rather than USPS-specific demographics and assumptions. Actuarial analysis commissioned by the Postal Service indicates that the OPM methodology results in higher liabilities and funding requirements than a USPS-specific calculate would yield:

*“OPM calculated that our portion of the FERS plan was underfunded by \$3.6 billion as of September 30, 2014. We continue to request that OPM reconsider its use of such government-wide factors and instead apply Postal Service-specific economic and demographic assumptions, which we believe would have resulted in a surplus of approximately \$1.2 billion as of September 20, 2014, the most recent period in which such comparisons have been calculated.”<sup>20</sup>*

Across all of the USPS retirement programs (FERS and retiree healthcare, in addition to CSRS), the OIG has estimated that use of Postal Service-specific assumptions would have generated a potential net reduction in liabilities of \$8.5 billion as of FY2012, subject to annual fluctuation since.<sup>21</sup>

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<sup>20</sup> USPS 2016 Report on Form 10-K, page 23.

<sup>21</sup> USPS OIG Report FT-WP-15-003, “Considerations in Structuring Estimated Liabilities,” January 23, 2015; FT-MA-13-022, “Using USPS – Specific Assumptions for Calculating the Retiree Health Care Liability,” September 27, 2013; FT-MA-13-024, “Using USPS – Specific Assumptions for Calculating the Federal Employees Retirement System Liability,” September 27, 2013; and FT-MA-13-023, “Using USPS – Specific Assumptions for Calculating the Civil Service Retirement System Liability,” September 27, 2013.

## **V. Reasonable Opportunities are Available to Reduce These Liabilities**

Over the long-term, funding retiree benefits at 100% levels using reasonable actuarial assumptions is an appropriate goal. At the same time – due to factors such as evolving longevity expectations as lifespans have tended to grow longer, market underperformance during the 2000-2010 decade, and the relatively short period of time since new accounting standards sharpened focus on the value of prefunding retiree healthcare – very few U.S. retirement plan sponsors are currently meeting this standard.

As a result, improving funded status is widely understood to often require a long-term, multi-decade funding approach. In addition, comprehensive retiree liability management should also include focus on capturing opportunities to reduce risk and cost exposure, rather than exclusively relying on increased funding.

In this regard, the Postal Service has advocated for several statutory reforms that would potentially provide financial relief from retiree benefit liabilities, and substantially, if not completely, resolve the current USPS unfunded liabilities.

One approach currently under Congressional consideration is encapsulated in H.R. 756, the Postal Service Reform Act of 2017. The proposed Act would authorize USPS to obtain its own medical insurance rating based on its own demographic pool and experience, would require full retiree medical insurance integration with Medicare, and would require OPM to value the USPS pension and OPEB liabilities based on the specific demographics and experience of USPS.<sup>22</sup>

The Postmaster General's testimony on H.R. 756<sup>23</sup> estimates a total reduction in the liability of \$54 billion from Medicare integration alone, substantially eliminating the USPS unfunded retiree

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<sup>22</sup> H.R. 756 (2017-2018); Statement of the Postmaster General before the House Oversight and Government Reform Committee Hearing, U.S. House of Representatives, February 7, 2017.

<sup>23</sup> Written Testimony of the Postmaster General before the House Oversight and Government Reform Committee Hearing, May 11, 2016, page 14. The Postmaster General cites this \$54 billion savings as eliminating 94% of the associated unfunded liability. It may be noted,

healthcare liability and any associated ongoing payments to amortize this obligation. In addition, this reform would also reduce the estimated ongoing normal costs for current service. Nationally, such Medicare integration is the standard practice across the state and local government sector and among large private companies that still offer retiree healthcare. For decades, the Postal Service and its employees have contributed into the Medicare system through payroll taxes, and it is reasonable for these integrated benefits to be received in return. Medicare integration would place the Postal Service on equal footing with its private sector competitors, eliminating what is now effectively a ratepayer subsidy for the overall Medicare system.

H.R. 756 would also direct OPM to prepare USPS actuarial valuations and estimates for pension and OPEB estimates using specific USPS demographics, workforce trends, and experience. As noted elsewhere in this report, this is another change that has been suggested numerous times by GAO and the USPS OIG, estimated by the OIG to potentially generate a net reduction in liabilities of \$8.5 billion.<sup>24</sup>

As also referenced elsewhere in this report, the assets held in trust by the Treasury for CSRS, FERS, and PSRHBFB are by law invested conservatively in special issue Treasuries restricted to maturities of 15 years or less.<sup>25</sup> While this requirement does provide stability and protection from risk and volatility, the conservative asset class and duration of the investments significantly lowers the discount rate used for pension assets compared to other public and private plans, which typically incorporate diversification in assets such as high-grade corporate bonds and equities.

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however, that the USPS 2016 Report on Form 10-K, page 27, cites the total estimated retiree healthcare liability as of September 30, 2016 to be \$52.1 billion.

<sup>24</sup> USPS OIG Report FT-WP-15-003, "Considerations in Structuring Estimated Liabilities," January 23, 2016; FT-MA-022, "Using USPS Assumptions for Calculating the Retiree Health Care Liability," September 27, 2013; FT-MA-13-023, "Using USPS Specific Assumptions for Calculating the Civil Service Retirement System Liability," September 27, 2013.

<sup>25</sup> U.S. Office of Personnel Management Civil Service Retirement and Disability Fund Annual Report, Fiscal Year Ended September 30, 2015; 2016 Report on Form 10-K.

Allowing diversification into higher-yield asset classes with longer duration would potentially increase long-term returns on the assets while also allowing OPM to appropriately apply a higher discount rate for valuation purposes, a change that would reduce the size of the reported unfunded liability. Legislation has been introduced to permit some diversification beginning with the USPS OPEB liability assets held in the PSRHBF, through H.R. 5707 in the previous 2015-2016 session of Congress, and H.R. 760 in the new 2017-2018 session. This legislation would allow up to 25-30 percent of the PSRHBF to be invested in index funds with an allocation patterned after the longest-duration target fund provided in the federal Thrift Savings Plan (“TSP”).<sup>26</sup> Compared to typical practice across the state and local government sector, this would continue to be an extraordinarily conservative investment approach.

The annualized savings estimated by the USPS<sup>27</sup> from its full set of proposed reforms, which include Medicare integration for retiree healthcare, use of Postal-specific actuarial assumptions for all retiree benefits, and flexibility to invest for retiree healthcare prefunding consistent with the longest duration “L” fund in the Thrift Savings Program, are included in Table 4 below. Note that any additional potential savings from even greater flexibility for pension investments and/or restructuring of benefit plan design are not assumed in Table 4.

Table 4 (\$ in billions)

	2018	2019	2020
Medicare Integration for Postal Retiree Health Plans and L-Fund investment for Postal Retiree Health Prefunding	4.4	4.3	4.2
Retirement Liability Calculation Using Postal-Specific Assumptions	0.7	0.7	0.7
Potential Savings	5.1	5.0	4.9

<sup>26</sup> House Report 114-859 on H.R. 5707

<sup>27</sup> Written Testimony of the Postmaster General before the House Oversight and Government Reform Committee Hearing, May 11, 2016, page 16.

It may also be noted that these potential savings as outlined in Table 4 would be over and above the approximately \$4 billion per year in annual savings already being experienced beginning in FY2017 under existing law based on the shift to an actuarial basis for retiree healthcare prefunding (with current retiree benefit payments made from the trust), rather than continuing the PAEA schedule of frontloaded, fixed payments.<sup>28</sup>

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<sup>28</sup> United States Postal Service 2016 Report on Form 10-K, page 28.

## **VI. With Over \$338 Billion in Retiree Benefit Prefunding Assets Already On Hand, Even Without Reform, the USPS is Not Projected to Face Budget Pressure From Payment Obligations for Many Years**

As of September 30, 2016, the USPS reported \$286.5 billion in pension plan assets and \$51.9 billion in retiree healthcare prefunding, for total assets of nearly \$338.4 billion. These resources provide significant funding capacity for an extended period that allows the Postal Service time to pursue the available reform opportunities that would reduce its long-term funding pressures without major rate increases.

To illustrate this capacity, the following analysis estimates the level of these assets remaining as of September 30, 2027 – just over ten years from now – assuming that the full benefit payment streams to USPS retirees are funded *solely* from the prefunded assets on hand as of September 30, 2016, with *no* additional contributions into these retirement funds. For this estimate, the following assumptions are used:

- Benefit payment streams are based on management projections for FY2017-FY2021 as included in the USPS financial statements.<sup>29</sup> For FY2022 through FY2027, we assume that the projected FY2021 payments would further increase each year thereafter by the average cost growth rate for the first five-year period. For retiree healthcare, note that this approach is more conservative than the USPS actuarial valuation assumption of declining medical inflation.
- Assets in the funds are assumed to earn interest consistent with the current federal actuarial assumptions and highly conservative investment practices (5.25% for pensions, 3.9% for retiree healthcare).

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<sup>29</sup> United States Postal Service, 2016 Report on Form 10-K, pages 25, 28.

- *All* benefits are assumed to be paid from assets in the funds with *no* additional contributions or pay-as-you-go funding made by the USPS.

With the above assumptions, in just over ten years, as of September 30, 2027:

- There would still be over \$111.0 billion in the CRS for Postal Service employees.
- There would still be nearly \$122.5 billion in FERS for Postal Service employees.
- There would still be over \$9.8 billion in the PSRHBFB.

In the aggregate, at the end of the ten-year period ahead, these three Postal Service retirement funds would be projected to have nearly \$243.3 billion in prefunding still available for retiree benefits – again, even with *no additional employer contributions*, no reform of investment practices, no Medicare integration, and no use of Postal-service specific actuarial assumptions.

Although the above projections should not be interpreted as a recommendation for the Postal Service to cease prefunding of its retirement liabilities, this analysis does illustrate that these funding challenges are multi-decade in nature rather than reflective of any immediate crisis. Sustainability can be responsibly addressed over time, without requiring precipitous increases to funding, potentially in conjunction with reasonable policy reforms that further reduce funding pressures.

## **VII. Other Balance Sheet Assets are Growing in Value and Stronger than They Appear in the Postal Service Financial Statements**

The condition of the Postal Service balance sheet is not just a function of the scale of USPS liabilities. A full evaluation should also assess the value of the assets available to offset such liabilities.

As of the end of FY2016, the USPS reported nearly \$8.1 billion in Cash and Cash Equivalents as assets in its financial statements,<sup>30</sup> a line item that has grown steadily in recent years from \$2.1 billion as of FY2012.

In addition, as of FY2016, the Postal Service reported \$15.3 billion in Property and Equipment, Net as assets in its financial statements. While this amount appears to have been reported consistently with Generally Accepted Accounting Principles (GAAP), past analyses have indicated that the market value for these assets – primarily real estate – is many times higher.

Pursuant to accounting treatment, real estate assets are recorded at cost, inclusive of interest for any capital borrowing, less allowances for depreciation and amortization. For depreciation, estimated useful lives are used that range from 3 to 40 years based on asset class under the straight-line method. This accounting approach can be referred to as “net book value.”

Alternatively, property and equipment – the majority of which is comprised of building, land, and leasehold improvements, with other categories including equipment and vehicles – can be viewed from a “fair market value.”

Past OIG reports indicate that the fair market value for the Postal Service real estate holdings would be far higher than the net book value shown in the financial statements. In a 2011 study, for example, the National Postal Museum property was found to have had a purchase price of

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<sup>30</sup> 2016 Report on Form 10-K, page 12.

\$47 million and an assessed tax value of \$304 million.<sup>31</sup> While this particular property may not be representative of all USPS real estate, the OIG developed an estimate of aggregate real estate value of \$85 billion based on long-term commercial real estate trends in a subsequent 2012 analysis<sup>32</sup> – more than six times the net book value of land and buildings.

Even at the 2012 estimated real estate value, the USPS fair market value would be approximately \$70 billion above the net book value for all property and equipment reported on the Postal Service balance sheet. Further, since this 2012 estimate was developed, U.S. commercial real estate prices have averaged more than double digit growth annually, increasing by 40.0% overall from Q4 2012 to Q4 2015 alone.<sup>33</sup> Applying these growth rate factors to the 2012 OIG estimate indicates potential 2015 Postal Service real estate fair market value of \$119 million – over \$100 million more than the reported net book value.

When addressing such Postal Service real estate assets, the OIG has noted:

*“Any discussion of unfunded liabilities should take into consideration assets that could be used to satisfy the liabilities.”<sup>34</sup>*

In public sector finance, there are often significant variances between accounting treatments and the numbers used for budgeting and other financial planning. In the case of real estate assets, for example, there may be the potential for future sale or sale/leaseback opportunities, and such transactions and any resulting proceeds would have returns driven by fair market value, not net

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<sup>31</sup> USPS OIG, FF-MA-11-118, “Management Advisory – Leveraging Assets to Address Financial Obligations,” July 12, 2011.

<sup>32</sup> USPS OIG FT-MA-12-002, Pension and Retiree Health Care Funding Levels,” June 18, 2012.

<sup>33</sup> International Monetary Fund, Commercial Real Estate Prices for United States© [COMREPUSQ159N], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/COMREPUSQ159N>, March 2, 2017

<sup>34</sup>USPS OIG FT-WP-15-003, “Considerations in Structuring Estimated Liabilities,” January 23, 2015.

book value. Accordingly, the more relevant perspective for taking these assets into account for financial analysis is the fair market value, not the GAAP net book value.

While Postal Service management has responded accurately to past OIG reports that such assets are often not immediately available to liquidate or pledge directly against retiree benefit liabilities, the true value of these assets is nonetheless quite relevant when evaluating long-term balance sheet condition. In the near-term and intermediate term, as the Postal Service itself has also noted, assets in excess of needs can be identified to obtain best value from lease or sale.<sup>35</sup> In other cases, strategies might be developed to relocate certain USPS operations to lower cost locations while monetizing the value of current, high value real estate. Perhaps most significant, in the event of a more severe technological or other long-term business disruption to the existing Postal Service business model somewhere in the decades far ahead, an even greater percentage of the significant fair market value of these real estate assets would become available to address any ongoing, unfunded obligations.

This fair market value represents an important safety net for the overall sustainability of the Postal Service's long-term finances, and, again, should be considered when evaluating this fiscal position. Further, to the extent that current fair market value has only been estimated, a more thorough review and valuation would be an important area for future study to accurately determine overall Postal Service financial condition going forward.

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<sup>35</sup> USPS OIG FT-MA-12-002, "Pension and Retiree Health Care Funding Levels," June 18, 2012.

## VIII. USPS Total Compensation Premium

Multiple past analyses have well-documented the substantial and longstanding compensation premium paid to USPS employees above the levels prevalent among comparable private sector workers. The 2003 Report of the President's Commission on the United States Postal Service, for example, found that:

*"Postal Service workers currently enjoy the best of both the public- and private-sector worlds – salaries akin to those offered by leading corporations, plus the substantial job security and benefits associated with Federal employment."* <sup>36</sup>

In testimony submitted to the 2003 Presidential Commission, Dr. Michael Wachter of the University of Pennsylvania outlined the long history of this comparability advantage, detailing his findings of a significant "wage and benefit premium" for Postal Service workers based on his detailed economic research, comparison of wages and benefits to private sector datasets, and extraordinarily low turnover. Dr. Wachter is a prominent cross-disciplinary scholar in the fields of law and economics, who has held full professorships in Economics, Management, and Law and Economics at the University of Pennsylvania's School of Arts and Sciences, Wharton School, and Law School respectively. As a labor economist, Dr. Wachter had been engaged by the Postal Service since 1981 as a compensation analyst and expert for employee interest arbitration.

Also in Dr. Wachter's testimony before the 2003 Presidential Commission, he cited multiple neutral arbitrators dating back to the early 1980's who have also independently found that a postal wage and benefit premium exists. For example, in a 2002 interest arbitration award between the Postal Service and the American Postal Workers Union ("APWU"), the neutral arbitration panel chair wrote:

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<sup>36</sup> Report on the President's Commission (2003), page 117.

*"In concluding that there exists a Postal Service wage premium, I join a long list of arbitrators who have reached the same conclusion."<sup>37</sup>*

Further, these arbitral findings of a wage premium continue through the most recent Postal Service proceedings. In a July 2016 APWU award, for example, the neutral panel chair wrote:

*"In weighing the parties' arguments on wage and benefit comparability, certain factors stand out. Initially, I am persuaded, as the Postal Service asserts, that the package of economic benefits received by bargaining unit employees – retirement benefits, retiree health care, paid leave, low employee health care contributions, and a no-layoff provision – are superior to those typically available to private sector employees. Another factor which stands out are the quit rate data, which show that career Postal Service employees voluntarily leave their jobs at a rate far lower than do private sector employees. Despite APWU arguments to the contrary, I consider this as powerful evidence that APWU-represented employees consider their jobs with the Postal Service to be superior to the alternatives available to them elsewhere."<sup>38</sup>*

For this report, we have updated these past analyses with several new and independent perspectives. The first of these new approaches compares cash compensation data developed by the BLS for three major Postal Service occupations relative to pay rates for comparable occupations in the broader labor market. These data are drawn from the BLS Occupational

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<sup>37</sup> President's Commission of the USPS, Statement of Michael L. Wachter, April 29, 2003, page 14.

<sup>38</sup> United States Postal Service and American Postal Workers Union, AFL-CIO, Interest Arbitration Decision and Award, Effective Date: July 8, 2016, page 11. Other analysts of the Postal Service's finances have also reached similar conclusions. In 2007, for example, the Federal Trade Commission similarly found that "Postal Service labor costs tend to be higher than private counterparts." (Federal Trade Commission, Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors, December 2007, page 37).

Employment Statistics (“OES”) program, the most comprehensive source of regularly produced occupational employment and wage rate information for the U.S. economy. The OES program surveys approximately 1.2 million nonfarm establishments to produce employment and wage estimates for about 800 occupations. The OES program produces these occupational estimates for the nation as a whole and varying geographic areas, and by ownership or industry corresponding to the North American Industry Classification System (“NAICS”) industrial groups. Wage estimates for the OES survey represent straight-time, gross pay, exclusive of premium pay – so does not include all forms of cash compensation such as shift differentials and overtime also earned by many USPS workers.<sup>39</sup>

Under the OES program, the three occupational categories specific and exclusive to the Postal Service are noted below, all falling within the broader BLS grouping of Postal Service Workers (43-5050): 43-5051 - Postal Service Clerks; 43-5052 - Postal Service Mail Carriers; and, 43-5053 - Postal Service Mail Sorters, Processors, and Processing Machine Operators.

In the tables that follow, OES median wages are presented for these three Postal Service occupations<sup>40</sup> relative to the median wages for comparable private sector occupations nationally as of the most recent reference period of May 2015. To determine comparable private sector occupations, the O\*Net OnLine database sponsored by the U.S Department of Labor was first used to identify occupations characterized as "related" based on similar job qualifications and

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<sup>39</sup> Bureau of Labor Statistics, U.S. Department of Labor, Occupational Employment Statistics [[www.bls.gov/oes/](http://www.bls.gov/oes/)].

<sup>40</sup> To validate the OES data, average (mean) hourly earnings were calculated from the National Payroll Summary of the U.S Postal Service for FY2015 pay period 11, which generally aligns with the most recent OES reference period. To align with the OES data that aggregates both career and non-career service Postal Service workers, full-time and part-time, in some cases spanning different bargaining units (e.g., City and Rural Letter Carriers), National Payroll Summary earnings and hours were similarly grouped. Although survey methodology and workforce fluctuations do cause some minor variances across these datasets, the overall averages (means) from OES and the averages calculated from the National Payroll Summary varied by less than 5.0% for all three job categories and by less than 1.0% for two of the three occupations. This congruence indicates a high degree of reliability for the OES results.

characteristics.<sup>41</sup> O\*Net typically identifies ten (10) occupations to be related. In turn, two of these related occupations were selected for each Postal Service category based on a particularly high degree of comparability, and included in the tables below. In addition to this BLS data, the pay scale ranges for common Postal Service pay grades within these categories – in both career and non-career positions – are shown in the bottom segment of each table.

### Mail Carriers

As shown in Table 5, the Postal Service Mail Carrier wage premium at median over these comparable private sector occupations was 95.3% above Light Truck or Delivery Services Drivers and 115.0% above Couriers and Messengers.

Table 5

Occupation (May 2015)	O*Net Description	Median
43-5052 Postal Service Mail Carriers	Perform any combination of tasks in a post office, such as receive letters and parcels; sell postage and revenue stamps, postal cards, and stamped envelopes; fill out and sell money orders; place mail in pigeon holes of mail rack or in bags; and examine mail for correct postage.	\$28.02
53-3033 Light Truck or Delivery Services Drivers	Drive a light vehicle, such as a truck or van, with a capacity of less than 26,000 pounds Gross Vehicle Weight (GVW), primarily to deliver or pick up merchandise or to deliver packages. May load and unload vehicle.	\$14.35
43-5021 Couriers and Messengers	Pick up and deliver messages, documents, packages, and other items between offices or departments within an establishment or directly to other business concerns, traveling by foot, bicycle, motorcycle, automobile, or public conveyance.	\$13.12

<sup>41</sup> O\*NET OnLine. National Center for O\*NET Development, n.d. Web. 20 Feb. 2017. <https://www.onetonline.org/>.

Table 5 - continued

<b>USPS Positions /Grades</b>	<b>Category</b>	<b>Range (May 2015)</b>
City Carrier 1	Career – Hired Before 1/12/2013	\$22.49 - \$28.51
City Carrier 2	Career – Hired Before 1/12/2013	\$23.43 - \$29.10
City Carrier 1	Career – Hired After 1/12/2013	\$17.53 - \$28.51
City Carrier 2	Career – Hired After 1/12/2013	\$17.90 - \$29.10
City Carrier Asst 1	Non-Career	\$15.68 - \$16.99
City Carrier Asst 2	Non-Career	\$16.01 - \$17.33

Of note, the Postal Service Tier 2 rate for City Carrier Assistants in effect as of May 2015 ranged from \$15.68 to \$17.33 per hour, depending on step and grade – a level more closely aligned with the market rates for comparable work in private industry. Including subsequent pay increases, the USPS Tier 2 rate for City Carrier Assistants in effect as of February 2016 ranges from \$16.06 to \$17.74.

Among the other private sector occupations identified by O\*Net as related but not charted above, median pay ranged from \$10.11 to \$14.25 per hour. In all cases, Postal Service workers maintained a significant wage premium, with comparable general labor market pay more consistent with the Postal Service Tier 2 rates.

#### Mail Handlers

As detailed in Table 6 that follows, the Postal Service Mail Handler wage premium at median over comparable private sector occupations was 98.5% above Mail Clerks and Mail Machine Operators, Except Postal Service and 97.7% above Weighers, Measurers, Checkers, and Samplers, Recordkeeping.

Of note, the Postal Service Tier 2 rate for Mail Handler Assistants in effect as of May 2015 ranged from \$14.37 to \$15.15 per hour, depending on step and grade – a level more closely aligned with the market rates in private industry. Including subsequent pay increases, the current Postal

Service Tier 2 rate for City Carrier Assistants in effect since November 2016 ranges from \$15.12 to \$15.94.

Table 6

<b>Occupation (May 2015)</b>	<b>O*Net Description</b>	<b>Median</b>
43-5053 Postal Service Mail Sorters, Processors, and Processing Machine Operators	Prepare incoming and outgoing mail for distribution. Examine, sort, and route mail. Load, operate, and occasionally adjust and repair mail processing, sorting, and canceling machinery. Keep records of shipments, pouches, and sacks; and other duties related to mail handling within the postal service.	\$27.28
43-9051 Mail Clerks and Mail Machine Operators, Except Postal Service	Prepare incoming and outgoing mail for distribution. Use hand or mail handling machines to time stamp, open, read, sort, and route incoming mail; and address, seal, stamp, fold, stuff, and affix postage to outgoing mail or packages. Duties may also include keeping necessary records and completed forms.	\$13.74
43-5111 Weighers, Measurers, Checkers, and Samplers, Recordkeeping	Weigh, measure, and check materials, supplies, and equipment for the purpose of keeping relevant records. Duties are primarily clerical by nature. Includes workers who collect and keep record of samples of products or materials.	\$13.80
<b>USPS Positions /Grades</b>	<b>Category</b>	<b>Range (May 2015)</b>
Mail Handler 4	Career – Hired Before 2/15/2013	\$16.91 - \$26.78
Mail Handler 5	Career – Hired Before 2/15/2013	\$17.67 - \$27.28
Mail Handler 4	Career – Hired After 2/15/2013	\$15.38 - \$26.78
Mail Handler 5	Career – Hired After 2/15/2013	\$16.08 - \$27.28
Mail Handler Asst 4	Non-Career	\$14.37
Mail Handler Asst 5	Non-Career	\$15.15

Among additional private sector occupations identified by O\*Net as related but not charted below, median pay ranged from \$10.01 to \$15.26 per hour. In all cases, Postal Service workers maintained a significant wage premium, with comparable general labor market pay more consistent with the Postal Service Tier 2 rates.

## Postal Clerks

For Postal Service Postal Clerks, as shown in Table 7, the wage premium at median over comparable private sector occupations was 86.5% above Shipping, Receiving, and Traffic Clerks and 115.0% above Tellers.

Table 7

Occupation (May 2015)	O*Net Description	Median
43-5051 Postal Service Clerks	Perform any combination of tasks in a post office, such as receive letters and parcels; sell postage and revenue stamps, postal cards, and stamped envelopes; fill out and sell money orders; place mail in pigeon holes of mail rack or in bags; and examine mail for correct postage.	\$27.30
43-5071 Shipping, Receiving, and Traffic Clerks	Verify and maintain records on incoming and outgoing shipments. Prepare items for shipment. Duties include assembling, addressing, stamping, and shipping merchandise or material; receiving, unpacking, verifying and recording incoming merchandise or material; and arranging for the transportation of products.	\$14.64
43-3071 Tellers	Receive and pay out money. Keep records of money and negotiable instruments involved in a financial institution's various transactions.	\$12.70
USPS Positions /Grades	Category	Range (May 2015)
APWU Grade 6	Career – Hired Before 5/23/2011	\$18.39 - \$27.30
APWU Grade 7	Career – Hired Before 5/23/2011	\$19.45 - \$27.88
APWU Grade 6	Career – Hired After 5/23/2011	\$18.39 - \$25.08
APWU Grade 7	Career – Hired After 5/23/2011	\$19.45 - \$25.77
Postal Support Employee	Non-Career	\$12.84 - \$16.97

Of note, the Postal Service Tier 2 rate for Postal Support Employees in effect as of May 2015 ranged from \$12.84 to \$16.97 per hour, depending on step and grade – a level more closely aligned with the market rates for comparable work in private industry. Including subsequent pay increases, the current Postal Service Tier 2 rate for Postal Support Employees in effect as of November 2016 ranges from \$13.51 to \$17.82. Similarly, among the other private sector O\*Net-identified related occupations, median pay ranged from \$10.11 to \$14.25 per hour. In all cases, Postal Service workers maintained a significant wage premium, with comparable general labor market pay more consistent with the Postal Service Tier 2 rates.

In past arbitrations, Postal Service unions have argued that the wage premium documented above is not present or as pronounced when measured against other selected industries, such as uniformed service delivery competitors for letter carriers or the telecommunications and airline industries for clerks.<sup>42</sup> Certainly, in any comparison of occupational pay, some industries will tend to pay more or less than others in wages. Such industry variations may be based on competitive pressures (or weakness of such pressures in a regulated industry), primary geographic location, unionization, differences in approach to benefits, historical evolution of that industry, and a broad range of other factors.

In practice, however, the Postal Service competes in the general labor market – not against just a handful of industries hand-selected by the unions for comparison. The pay comparability statute reflects that: compensation and benefits of postal employees should be comparable to the “compensation and benefits paid for comparable levels of work in the private sector of the economy”<sup>43</sup> not comparability with a limited subset of the private sector carved out based on isolated factors. By looking at wages for similar occupations across all U.S. private industry, our analysis comports more closely with this federal policy, as the job qualifications and

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<sup>42</sup> See, for example NALC 2013 arbitration award page 7, and APWU 2016 arbitration award, page 10.

<sup>43</sup> 39 U.S.C. §1003(a) (39 U.S.C. § 101(c) is to the same effect).

characteristics of the related occupations identified by O\*Net align well with the “levels of work” in the USPS categories.

Further, our comparison aligns with the full labor market within which the Postal Service recruits and retains. In this context, both the almost nonexistent quit rates for career USPS positions, and the Postal Service’s ability to routinely fill non-career positions at lower Tier 2 rates despite the lack of job security, undesirable schedules, and limited benefits all indicate that true market wages and benefits for comparable levels of work are well below those of Postal Service career positions - and well below those of any other anomalous employers with compensation approaching such levels.

## IX. USPS Benefits Premium

In addition to a substantial wage premium, Postal Service workers receive exceptionally generous benefits as a further component of total compensation. In some notable cases, these benefits are currently determined by federal statute – including pension benefits, participation in the federal employee health benefits system, and retiree healthcare coverage. In other cases, such as paid leave and active employee healthcare premium contributions, Postal Worker benefits are – or can be – determined primarily through collective bargaining. In both cases, the high value of Postal Service benefits adds to the overall total compensation premium above comparable private sector norms.

### Postal Service Retirement Benefits

Postal Service employees hired since 1987 participate in FERS, which provides both a defined benefit basic annuity and a defined contribution TSP component, in addition to Social Security coverage. This FERS program can be characterized as a “hybrid” retirement plan that combines both defined benefit and defined contribution features.<sup>44</sup>

In comparison, as outlined in the table that follows drawing on data from the BLS National Compensation Survey as of March 2016, most private sector employees now receive only a 401(k)-style defined contribution benefit, which typically has a lower cost and less risk for the employer, and less replacement income and retirement security for participating employees. As the OIG found in a 2014 white paper on retirement benefits:

*“Private company and public sector retirement plans have undergone significant changes over the past 20 to 30 years. Pension plans used to be the most common*

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<sup>44</sup> FERS was not enacted into law until 1987. Congress halted new enrollment into the CSRS in 1983, but did not determine the structure of FERS until 1987. During the transition period between 1983 and 1987, federal employees were offered a transition plan called CSRS Offset, which consisted of a modified CSRS pension and Social Security benefits.

*form of retirement plan in the U.S., but recently 401 (k) plans have become more popular. Benchmarked organizations are phasing out costly pension programs and implementing 401 (k) matching programs.”<sup>45</sup>*

In FY2016, based on analysis of the Postal Service National Payroll Summary, the USPS contributed approximately \$3.73 per employee hour worked toward retirement benefits, excluding Social Security and retiree healthcare. In contrast, the typical contribution in private industry was just \$1.25 per hour worked according to the BLS Employer Costs for Employee Compensation (“ECEC”) report.<sup>46</sup>

In addition, the USPS provides retiree lifetime healthcare coverage in the Federal Employees Health Benefits (“FEHB”) program for former employees who participated in the FEHB for the five years prior to retirement, as well as qualifying survivors. Retirees contribute toward premiums at the standard federal rate of 28% of the weighted average cost. In contrast, retiree healthcare has become increasingly rare in the private sector. Again according to the March 2016 BLS National Compensation Survey, only 15% of U.S. private industry workers have access to retiree healthcare prior to age 65, and only 13% thereafter. Among workers in establishments with 500+ employees, 38% have access prior to age 65, and only 32% thereafter. In many cases, these benefits are capped at fixed dollar amounts.

These pension and retiree healthcare comparisons are summarized in Tables 8 and 9 on the following pages.

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<sup>45</sup> Office of Inspector General, United States Postal Service, “Postal Service Retirement Benefits Benchmarking,” Report Number HR-WP-14-002 (May 1, 2014), page 2.

<sup>46</sup> BLS Employer Costs for Employee Compensation – September 2016.

Table 8

	USPS	U.S. Private Industry
Retirement Income Replacement	<p>Under FERS:</p> <p>Defined benefit basic annuity based on a formula of 1% of average salary for an employee's three highest consecutive years multiplied by years of service if under age 62 at retirement or with less than 20 years of service; 1.1% multiplied by years of service if age 62 or older with 20 years of service</p> <p>+</p> <p>Defined contribution of 1% of basic pay and matching percentages of voluntary employee contributions for up to an additional 4% of basic pay (5% maximum overall)</p> <p>+</p> <p>Employer Social Security contributions of 6.2% of pay</p>	<p>Only 18% of all workers in U.S. private industry still have access to a traditional defined benefit pension plan, and less than half (43%) have access in establishments with 500+ employees. Of those companies that continue to provide such benefits, many have closed their plans to new employees<sup>47</sup></p> <p>Most private sector workers have access to a defined contribution plan, typically a 401-k (62% of all workers and 82% in establishments with 500+ employees). Where offered, the median employer contribution is a match of up to 3% of salary for private industry all workers, and 4% in firms with 500+ employees</p> <p>Employer Social Security contributions of 6.2% of pay are standard</p>

<sup>47</sup> National Compensation Survey: Employee Benefits in the United States, March 2016

Table 9

	USPS	U.S. Private Industry
Retiree Healthcare	<p>Lifetime healthcare coverage in the Federal Employees Health Benefits (“FEHB”) program is available for retirees who participated in the FEHB for the five years prior to retirement, as well as qualifying survivors. Retirees contribute toward premiums at the standard federal rate of 28% of the weighted average cost</p> <p>The Postal Service also contributes 1.45% of salary toward Medicare during employees’ active service, however, Postal Service retirees are not required to participate in Medicare coverage that would substantially reduce the cost to the USPS of post-65 coverage</p>	<p>Only 15% of U.S. private industry workers have access to retiree healthcare prior to age 65, and only 13% thereafter. Among workers in establishments with 500+ employees, 38% have access prior to age 65, and only 32% thereafter. In many cases, these benefits are capped at fixed dollar amounts</p> <p>Employer Medicare contributions of 1.45% of pay while active are standard, as is post-65 participation in Medicare</p>

### Paid Leave

Postal Service paid leave benefits are also highly generous relative to private sector norms, which can drive staffing requirements, replacement needs, and/or overtime. The following Table 10 compares USPS paid leave to BLS National Compensation Survey medians for all U.S. Private Industry workers and for those in establishments with 500 or more employees.<sup>48</sup>

<sup>48</sup> Bureau of Labor Statistics, U.S. Department of Labor, *National Compensation Survey*, March 2016 ([www.bls.gov/ncs/](http://www.bls.gov/ncs/))

Table 10

	USPS	U.S. Private Industry
Vacation / Annual Leave	<p>&lt; 3 years: 13 Days</p> <p>3-15 years: 20 Days</p> <p>After 15 years: 26 Days</p>	<p>For all workers:</p> <p>After 1 year: 10 days</p> <p>After 5 years: 15 days</p> <p>After 10 years: 15 days</p> <p>After 20 years: 20 days</p> <p>For workers in establishments with 500+ employees:</p> <p>After 1 year: 12 days</p> <p>After 5 years: 15 days</p> <p>After 10 years: 20 days</p> <p>After 20 year2: 24 days</p>
Paid Holidays	10 days annually	<p>7 days annually for all workers</p> <p>9 days annually in establishments with 500+ employees</p>
Sick Leave Accrual	13 days annually	<p>6 days annually for all workers</p> <p>7 days annually for the first five years and 8 days per year thereafter in establishments with 500+ employees</p>

#### Health Benefits (Active Employees)

By federal statute, active Postal Service workers participate in the Federal Employees Health Benefits Program (“FEHBP”), with employer contributions toward premium costs collectively

bargained with the Postal Service unions. Overall, these active employee health benefits are more costly than private industry, and the Postal Service's subsidy toward premium costs is larger than that provided by the federal government for its own employees within the FEHBP.

For Plan Year 2016, Postal Service workers represented by the APWU paid 24% of the weighted average premium costs for all levels of coverage (self, self plus one, and family), rising to 25% in Plan Year 2017, 26% in FY2018, and 27% in FY2019. Similarly, both the National Rural Letter Carriers' Association ("NRLCA") and National Postal Mail Handlers Union ("NPMHU") employee premium contributions phase up to 27% by 2019. For the largest Postal Service union, the National Association of Letter Carriers ("NALC"), contributions remain at 24% based on the most recent contract that expired in 2016.<sup>49</sup> In the same FEHBP, most federal government employees and annuitants as of 2017 contribute the greater of 28% of the program-wide weighted average of premiums in effect each year or 75% of the total premium for the particular plan an enrollee selects.<sup>50</sup>

In U.S. private industry, the March 2016 BLS National Compensation Survey reported that employees typically contributed 32% of premium costs for family medical coverage (25% among large establishments with more than 500 workers) and 21% for individual coverage (20% among large establishments). According to the BLS ECEC report, employers across all industries in 2016 spent \$2.44 per hour worked on health insurance.<sup>51</sup> In FY2016, based on analysis of the Postal Service National Payroll Summary, the USPS contributed approximately \$3.71 per employee hour worked.<sup>52</sup>

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<sup>49</sup> Employee premium contributions shown reflect the standard employee contribution, based on the weighted average cost of premiums across available plans. In some cases, subject to caps on the employer contribution also included in each collective bargaining agreement, contributions as a percentage of the premium cost for particular plans selected will vary.

<sup>50</sup> FEHB Handbook <https://www.opm.gov/healthcare-insurance/healthcare/reference-materials/reference/cost-of-insurance/>

<sup>51</sup> ECEC, September 2016

<sup>52</sup> National Payroll Summary, 2016

## X. Recruitment and Retention

The extraordinarily low turnover experience of USPS workers and relative ease of filling vacant positions provide further strong indication that current Postal Service compensation substantially exceeds market levels. As Dr. Wachter testified before the 2003 President’s Commission, as a complement to his analysis of comparative economic labor market data:

*“[W]e concluded that a significant wage premium exists. If this conclusion is correct, two implications follow. First, postal workers should have relatively low quit rates. All other factors being the same, dissatisfied workers quit their jobs. Second, the Postal Service should find it easy to hire qualified workers to fill job vacancies. In addition, if both of these factors can be shown, then the converse is also true. Unusually low quit rates and long employment queues imply the existence of a compensation premium.”*<sup>53</sup>

As shown in Table 11, a 2015 USPS OIG report cited annual voluntary resignations among career service workers prior to retirement (“quit rate”) at less than 1% of the workforce across the major bargaining units, far below equivalent rates cited for the private and federal sectors.<sup>54</sup>

Table 11

	2009	2010	2011	2012	2013
NALC	0.6%	0.5%	0.5%	0.5%	0.5%
APWU	0.5%	0.8%	0.5%	0.4%	0.4%
NRLCA	0.4%	1.2%	0.5%	0.6%	0.7%
NPMHU	0.7%	0.4%	0.5%	0.6%	0.4%
Private Sector	19.1%	18.7%	20.0%	21.0%	22.3%
Federal Sector	2.7%	4.9%	3.7%	4.7%	4.8%

<sup>53</sup> Wachter testimony, page 7.

<sup>54</sup> USPS OIG RARC-WP-15-004, “Flexibility at Work: Human Resource Strategies to Help the Postal Service,” January 5, 2015, page 12.

The 2016 APWU arbitration award also cited similar trends of less than 1.0% quit rates for senior career employees and less than 5.0% for newer hires among members of that major Postal Service bargaining unit. As the neutral chair of the arbitration panel wrote:

*"To be sure, wages and benefits are not the only considerations that enter into an employee's decision whether to stay with the Postal Service or go elsewhere, but it would be naïve to believe that these are not major considerations. Hence, I conclude that the almost total unwillingness of APWU-represented employees to leave their jobs voluntarily is powerful evidence that they view their compensation and benefits as superior to what they would receive elsewhere, based on their skill and experience."*<sup>55</sup>

While quit rates for non-career employees are markedly higher than for career service employees, such increased turnover is to be expected for what are essentially temporary positions with no job security, limited benefits, and inflexible and unpredictable schedule demands associated with the use of these employees as last minute fill-ins for absences. Within the Postal Service, the USPS OIG has found that these inherent challenges are often compounded by insufficient mentoring and training non-career employees, as well as negative supervisory relationships.<sup>56</sup> At the same time, in evaluating non-career employee turnover, the OIG report cited three separate findings indicating that pay is not a major driver of non-career employee resignations:<sup>57</sup>

- First, analysis of USPS exit surveys of non-career employees for FY2016 (through July 2016) found that pay ranked 9th out of 11 reasons given for resignation, cited by only 6.24% of those separating. Ranking ahead of pay were: "Lack of schedule flexibility;"

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<sup>55</sup> APWU 2016 Award, pages 7-8, and 11.

<sup>56</sup> USPS OIG "Non-Career Employee Turnover," HR-AR-17-002, December 20, 2016, pages 1-2.

<sup>57</sup> USPS OIG "Non-Career Employee Turnover," HR-AR-17-002, December 20, 2016, pages 7-9.

“Didn't like supervisor;” “Physical demands;” “Too many hours;” “Not enough hours;” “Lack of advancement opportunities;” “Lack of benefits;” and, “Wasn't trained.”

- Next, the OIG conducted its own web-based survey, and similarly found pay to rank behind "Supervisor not treating people with respect/Poor management skill," "Lack of schedule flexibility," and "Lack of benefits" among the top reasons non-career employees have resigned.
- Finally, the OIG conducted in-depth interviews with current non-career employees, and again found issues including "Lack of flexibility," "Lack of training," and "Supervisor not treating people with respect" to rank well above compensation among the top concerns with their positions.

Consistent with these findings, the Postal Service has also stated that:

*“Most frequently cited causes for non-career employee turnover are lack of schedule flexibility, physical demands, and employee did not like supervisor.”<sup>58</sup>*

While such non-economic issues are of concern, and may represent further opportunities for workforce cost savings if successfully addressed to reduce non-career employee turnover and replacement costs, there is no indication that the pay rates for these positions are inadequate. To the contrary, the Postal Service's success in routinely filling approximately 130,000 non-career positions nationally *despite* these limitations indicates the attractiveness and market competitiveness of Tier 2 pay rates for the type of work performed.

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<sup>58</sup> Responses of the United States Postal Service to Questions 4-7 and 10 of Chairman's Information Request No. 14, Annual Compliance Review 2016, February 15, 2017, page 3.

## **XI. Past USPS Cost Containment Efforts and Remaining Untapped Opportunity**

Past partial cost containment measures negotiated by the USPS, primarily impacting newly hired personnel, have demonstrated the potential for significant compensation restructuring and savings if built upon and further expanded. For the majority of on-board Postal Service employees, however, wage growth has continued to outpace consumer price growth as well as federal employee wage gains, despite the long-documented presence of the wage premiums outlined above. Going forward, strengthened controls represent a strong and largely untapped opportunity to moderate cost growth prospectively.

### USPS Wage Trends for Incumbent Employees

Postal Service employees can receive pay increases in multiple ways. Individuals typically move through steps on a pay schedule based on tenure, and may also advance to higher pay grades on this same schedule based on increased responsibility and assignments/promotion. Independent of such individual advancement, the pay schedule as a whole can also be adjusted, which generally takes place through collective bargaining for the majority of Postal Service workers represented by one of several different unions. In addition, again primarily through collective bargaining, various premium pays (e.g. night differential and uniform allowances) can also be periodically adjusted.

The following analysis focuses primarily on increases to the Postal Service basic annual salary schedules, which effectively improve pay opportunities “across the board.” Again, with step progression and other adjustments, individuals typically experience even greater pay gains over time.

With regard to the basic salary schedules, the Postal Service and its unions have traditionally negotiated two types of improvements for career service employees:

- The major Postal Service collective bargaining agreements all include formula-driven cost of living adjustment (“COLA”) provisions. These formulas are based on the BLS National Consumer Price Index for Urban Wage Earners and Clerical Workers (“CPI-W”), increasing all pay scales by 1 cent per hour for each 0.4 point increase in the CPI-W index, typically twice per calendar year.<sup>59</sup> Of note, pay scales are not adjusted downward when the CPI-W declines, as has occurred during some recent periods. Because this COLA formula generates the same increase in cents per hour for all employees, regardless of pay level prior to the COLA, the formula yields a higher percentage increase in pay for employees with lower salaries, and a lower percentage increase in pay for those employees with higher salaries, without directly matching CPI-W index percentage change.
- In addition, general wage increases beyond these COLAs have been negotiated in most, but not all calendar years over the past, approximately ten-year period since the passage of the PAEA. When granted, these additional increases have ranged between 1.0% and 1.9% annually.

The existence of a COLA provision in addition to general wage increases is an uncommon structure, no longer found in most collective bargaining agreements. According to a Bureau of National Affairs (“BNA”) survey of 167 labor agreements across the U.S. as of 2015, only 9% featured a COLA provision – and only 7% of agreements outside of the manufacturing sector.<sup>60</sup>

In the aggregate, again, across the past, approximately ten-year period since the passage of the PAEA, the combination of the Postal Service’s COLAs and general wage improved the pay

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<sup>59</sup> Deferrals have been negotiated in some years, for example the 2013 COLAs for the four major USPS unions were deferred until 2014 either by negotiations or arbitration awards. In 2015, none of the union employees received COLAs. In 2016 APWU, NPMHU, and NRLCA reached resolutions with a COLA base month of July 2014 with no retroactive COLA payments. At the end of 2016, USPS and NALC were still in negotiations. See Report on Form 10-K pages 21-22 and NPMHU Summary of Tentative Agreement Establishing Terms of 2016 National Agreement.

<sup>60</sup> Bloomberg BNA, Employer Bargaining Objectives 2016, page 33.

schedules for on-board Postal Service employees at rates generally in excess of growth in overall consumer prices. To illustrate these trends, the following analysis compares wage growth for the two largest Postal Service bargaining units, the NALC and APWU.

Looking first at the NALC, wage growth is compared to national CPI-W growth across the two labor contract periods covering from November 21, 2006 through May 20, 2016. This period is linked directly to labor agreement contract duration and was selected to avoid any potential for distortion in wage growth analysis. In some cases, negotiated wage increases may be “backloaded” or “frontloaded” within a multi-year agreement, such that splitting a contract period can present a skewed view of longer-term pay trends. By aligning directly with the contract periods, any potential for such distortion is avoided, while still presenting an approximately decade-long perspective that substantially overlaps with the with ten-year period since the passage of the PAEA.

For the NALC trend analysis that follows, wage growth is calculated by starting with the pay schedules still in effect just prior to the start of this period (October 2006) and evaluating the cumulative change made through the pay schedules in effect at the end of these contract periods (May 2016). In parallel, CPI change from October 2006 through May 2016 is calculated to determine how consumer price change over this same period compares to such NALC pay schedule adjustments.

For this analysis, two series of the CPI are used. The first is the same national CPI-W used in the Postal Service labor agreement COLA provisions, which is aligned with price change in the typical market basket of wage earning households. The second series included is the Chained Consumer Price Index for All Urban Consumers (“C-CPI-U”). The C-CPI-U employs a formula that reflects the effect of substitution that consumers make across item categories in response to changes in relative prices. For example, if the price of beef escalates, consumers may simply choose to buy more chicken or pork, rather than continuing to buy the higher-priced beef – and

may be indifferent about such a switch. This substitution behavior is accounted for in the C-CPI-U by linking the index to actual expenditure patterns, while the more traditional CPI-W does not take such behavior into account. As a result, the BLS characterizes the C-CPI-U as “designed to be a closer approximation to a cost-of-living index than other CPI measures,”<sup>61</sup> such as the CPI-W.

In addition, trends in the BLS Employment Cost Index (“ECI”) wages and salaries index for U.S. private industry were also evaluated. The ECI measures the change in the cost of labor, free from the influence of employment shifts among occupations and industries. In other words, the ECI indicates pay trends assuming each occupation remains a consistent component of the workforce. To the extent that more jobs may shift, for example, from higher paid manufacturing into lower paid service occupations, this effect would be factored out.

Finally, growth in federal employee pay scales is also shown from 2006 to 2016. For federal employees, base pay schedules can be modified to incorporate locality pay adjustments that reflect regional market wages in certain higher paying areas of the nation. These locality pay adjustments can vary from year to year as market conditions fluctuate regionally, such that federal pay trends can differ from one location to another. In the tables in this report, locality pay adjustments are presented for the Rest of the United States (RUS) outside of specific locality pay areas, which represents the largest grouping of federal employees. Of note, this approach reflects higher federal pay growth than would be shown if only general wage increases were presented without locality pay.

As noted above, pay growth in percentage terms can also vary across Postal Service positions because the COLA component of wage adjustments is granted on a fixed dollar, rather than percentage, basis. Accordingly, cumulative growth is shown below for both major pay grades on

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<sup>61</sup> BLS, C-CPI-U Frequently Asked Questions, <https://www.bls.gov/cpi/cpisupqa.htm> [downloaded March 15, 2017].

the NALC pay schedule for career employees, using the top step for each classification. At lower pay steps, COLA impact would be greater as a percentage of pay such that NALC pay growth overall would be higher on average.

**Table 12: NALC Pay Schedule Growth vs. Economic Indicators (10/06-5/16)**

<b>City Carrier Grade 1 Top Step</b>	<b>City Carrier Grade 2 Top Step</b>	<b>CPI-W</b>	<b>C-CPI-U</b>	<b>ECI</b>	<b>Federal Employees</b>
21.6%	21.4%	18.4%	17.0%	22.0%	14.0%

As shown in Table 12 above, NALC wage growth has outpaced both consumer price change and federal employee raises.

While NALC top step wage growth is marginally behind ECI growth by a cumulative 0.4% - 0.6% over approximately a decade, this minimal lag has done little, if anything, to reduce the Postal Service compensation premium. In part, this is, again, because the COLA structure results in higher percentage gains for the steps below maximum not shown above. In addition, the private sector has experienced steady reductions in retirement benefits across this period, while the USPS continues to provide a defined benefit pension component and extraordinary retiree healthcare subject to medical inflation cost growth. As a result, total compensation trends have almost certainly been more favorable for the USPS than pay trends alone.

Further, this nominal difference in relative wage growth compared to the ECI falls well short of past goals for reducing the Postal Service wage premium over time. During the 1980s and 1990s, Dr. Wachter's testimony to the President's Commission reports a Postal Service goal across that period of moderating wage increases by 1% per year compared to the private sector as a strategy for incrementally reducing the USPS wage premium. As a guidepost for this approach, the Postal Service used ECI change less 1% per year. Again, from 2006 to 2016, the actual moderation

achieved was only a *cumulative* 0.4% - 0.6% below the ECI, or less than one tenth of one percent per year.

The following analysis benchmarks APWU trends against the same economic indicators. Consistent with the preceding methodology, the time frame selected captures the two full contract periods that most closely align with the past ten-year period – in this case from November 21, 2006 through May 20, 2015, one year less than covered by the two parallel NALC agreements.

It may be noted that the APWU has also reached a successor agreement with the Postal Service covering the period from May 21, 2015 through September 20, 2018. To avoid the potential for skewing comparisons by splitting contract periods, and because comparative economic trends for future periods are inherently not yet known with certainty, this most recent APWU agreement will be addressed following the trend analysis below.

Over the period from October 2006 through May 2015 that captures all APWU pay and economic indicator changes over the last two contract periods, APWU pay schedule top step gains also outpaced the two CPI indicators and were within 0.6% to 0.8% of national ECI gains on a cumulative basis. APWU pay schedule improvements also exceeded increases to the federal pay schedule from 2006 to 2015 inclusive of locality pay (RUS). Noting that pay growth in percentage terms can vary across Postal Service positions, cumulative growth below is shown for the commonly used APWU pay levels, Grades 6 and 7. Note also that the APWU collective bargaining agreement shifted the pay schedule upward by one grade for all employees in 2008, during the time period evaluated. This negotiated general adjustment is accounted for within the analysis shown below in Table 13.

**Table 13: APWU Pay Schedule Growth vs. Economic Indicators (10/06-5/15)**

<b>Grade 6 Top Step</b>	<b>Grade 7 Top Step</b>	<b>CPI-W</b>	<b>C-CPI-U</b>	<b>ECI</b>	<b>Federal Employees</b>
18.3%	18.1%	17.6%	16.1%	18.9%	12.7%

As noted above, a successor agreement is in place for the APWU from May 21, 2015 through September 20, 2018 based on an interest arbitration award issued July 8, 2016 that generally parallels an agreement previously negotiated at arms-length between the Postal Service and the NRLCA. This most recent APWU agreement continues the unusual COLA provisions already in place, adds general wage increases beyond the COLAs in each year, features only limited new benefit cost containment, reduces management flexibility to use non-career staffing, and leaves many untapped opportunities for prospective savings:

- Continued COLAs.
- Additional general wage increases above the COLA of 1.2%, 1.3%, and 1.3% over the three-year contract period.
- Elimination of Tier 2 non-career positions in the Maintenance and Motor Vehicle Crafts and mandated conversion of longer-tenured Clerk Craft tier 2 workers into Tier 1 career positions.
- No further expansion of Tier 2 in other areas, and no further moderation in the pay scale for future hires.
- Only moderate health cost containment, reducing the Postal Service contribution toward health care premiums from 76% to 73% of cost over the three years, still above the standard federal contribution of 72% for its own employees participating in the FEHB.

While Postal Service wages will continue to grow under this new agreement, inflation remains quite low – increasing only 0.7% in the CPI-W and 0.8% in the C-CPI-U from May 2015 to May 2016, the first year of this new agreement term above.

In addition to slowing progress with addressing the wage and benefit premium generally, the Postal Service has recently increased overall headcount – and has done so with proportionately lower use of more affordable non-career employees.<sup>62</sup> Progress in overall workforce reduction and flexibility, while only partially advanced, drove most of the USPS progress in cost containment following 2006<sup>63</sup>, but has now begun to reverse.

A 2014 GAO study found that, from the end of FY2006 through FY2013, “USPS decreased the size of its workforce, increased its percentage of non-career employees, and decreased its employee work hours.”<sup>64</sup> Over this period:

- The overall USPS workforce declined by approximately 22% from 796,000 to 618,000 employees.
- The number and percentage of non-career employees increased from approximately 100,000 workers (13% of the total workforce) to approximately 127,000 (21% of the total workforce).
- Total work hours decreased from 1.46 billion to 1.11 billion.

Reduced demand for certain services, operational changes, and adoption of new technologies have all been factors cited as contributing to this change.

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<sup>62</sup> 2016 Report on Form 10-K, page 21.

<sup>63</sup> USPS OIG RARC-WP-16-009 “Peeling the Onion: The Real Cost of Mail,” (April 2016), pages 8-10.

<sup>64</sup> GAO-15-43, “USPS Status of Workforce Reductions and Related Planning Efforts,” (November 2014).

Since FY2013, however, the USPS workforce has increased by 3.6% – attributed by Postal Service management to growing staffing demands for growth in the Shipping and Packages business and in the delivery network.<sup>65</sup> From 2014 to 2016, the USPS has increased its total workforce by 22,000 employees, from 618,000 to 640,000. In turn, of the 22,000 net positions added by the Postal Service in recent years, 21,000 of these incremental positions were Tier 1 career employees. In other words, 95.5% of the Postal Service job growth over the past two years has been concentrated in career service positions. As a result, the percentage of USPS Tier 2 employees *declined* from 21.0% in FY2014 to 20.9% in FY2015 to the FY2016 level of 20.5%, moving staffing practices in the direction of higher costs.

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<sup>65</sup> 2016 Report on Form 10-K pages 20-21.

## XII. Cost Control Options Looking Forward

Many of the Postal Service compensation costs are linked to existing collective bargaining agreements. As shown in Table 14, the contract periods for the three largest unions<sup>66</sup> representing a majority of the Postal Service workforce, however, will expire within the next 18 months, and none of the four major union agreements extends beyond 2019.

Table 14

Postal Service Union	Current Contract Expiration
NALC	5/20/2016
APWU	9/20/2018
NRLC	5/20/2018
NPMHU	9/20/2019

Accordingly, a majority of the decade ahead will take place during a period when strategies for personnel cost containment can be more actively pursued toward meeting the statutory goal of private sector comparability.

In February 2017 testimony before the U.S. House of Representatives Committee on Oversight and Government Reform, the GAO addressed Postal Service compensation and benefits issues in an environment of revenue pressures:

*“To put USPS’s situation into context, many private sector companies (such as automobile companies, airlines, mail preparation and printing companies, and major newspapers) took far-reaching measures to cut costs (such as reducing or stabilizing workforce, salaries, and benefits) when demand for their central product and services declined.”*<sup>67</sup>

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<sup>66</sup> Findings regarding the scale of union representation based on the Postal Service Active Employee Statistical Summary (HAT Report), Pay Period 04 FY2017, February 21, 2017

<sup>67</sup> GAO-17-404T, “USPS Key Considerations for Restoring Fiscal Sustainability,” (February 7, 2017), pages 12-13.

Among the approaches available to the Postal Service, significant cost moderation could be achieved over time by simply limiting further Tier 1 wage growth, rather than continuing to layer on pay improvements above consumer price change by combining both an outdated COLA structure and general wage increases. As noted previously, until recent rounds of bargaining, arbitrators had sought to constrain Postal Service wage growth below general labor market trends in recognition of the large existing wage premium, allowing the market to at least begin to partially close the gap.

With potentially even greater impact, the Postal Service could also build on and expand its use of additional salary and benefit tiers. From 2006 to 2015, the OIG reports that the Postal Service substituted non-career service employees for its more expensive career workforce at a rate of about 3.0% per year on average.<sup>68</sup> In addition, for new hires into the career service, the Postal Service negotiated moderately lower wage scales in agreements taking effect between 2010 and 2013, creating new permanent tiers.<sup>69</sup> Again according to OIG analysis, these measures contributed to an approximately 0.3% average annual decrease in USPS wage costs per work hour from 2006 to 2015, as measured in constant dollars.<sup>70</sup>

As noted above, more recent settlements and arbitrations awards have not sustained this cost control trend, and in some respects have partially reversed this progress. This round began with the NRLCA voluntary agreement negotiated by the Postal Service at arms-length in April 2016, establishing a pattern subsequently cited by the neutral for the APWU in binding interest arbitration.<sup>71</sup>

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<sup>68</sup> USPS OIG, RARC-WP-16-009, “Peeling the Onion: The Real Cost of Mail,” April 18, 2016, page 8.

<sup>69</sup> 2016 Report on Form 10-K, page 21; individual collective bargaining agreements NLCA, APWU, NRLCA, NMPHU.

<sup>70</sup> USPS OIG, RARC-WP-16-009, “Peeling the Onion: The Real Cost of Mail,” April 18, 2016, page 11.

<sup>71</sup> United States Postal Service and American Postal Workers Union, AFL-CIO, Interest Arbitration Decision and Award, Effective Date: July 8, 2016, Page 12.

Given the Postal Service’s continued, extraordinarily high compensation premium among career service employees relative to the private sector, as well as career staffing increases since 2014 (both absolute and proportional), there is clearly opportunity to not only renew past cost containment approaches, but also to accelerate them significantly while still maintaining the ability to recruit and retain a quality workforce.

Tiered wage and benefit programs are a longstanding human resources approach, well-established across industries and within the public sector, and remain common nationally in unionized environments. Writing in 1990, academic researcher Dr. James E. Martin of Wayne State University cited literature tracing the history of such practices in the U.S. back to the 1930s, and finding significantly increased adoption beginning in the 1980s.<sup>72</sup> Dr. Martin defines compensation tiers as “the result of a compensation system change that adds lower compensation levels for workers who either change positions or begin employment after a certain date.”<sup>73</sup> Dr. Martin further classifies tiered compensation systems as either “permanent” or “temporary” – with the former retaining a lower compensation structure for newer hires indefinitely, and the latter providing for the lower compensation of newer hires to eventually catch up with and merge into the higher compensated tier. In addition, Dr. Martin distinguishes “employment status tiers” with part-time or otherwise non-career groups compensated at lower levels, and also details how tiers can encompass wages, benefits, or both.<sup>74</sup>

Dr. Martin’s work more than a quarter of a century ago cited the BNA as the “most comprehensive source of information about two-tier settlements.”<sup>75</sup> To update our analysis for this report, we evaluated BNA findings as published in a 2016 report. These findings, drawn from a 2015 survey of unionized employers nationally, found that nearly one-third (31%) of the

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<sup>72</sup> Martin, James E. and Thomas D Heetderks, “Two-Tier Compensation Structures, Their Impact on Unions, Employers, and Employees,” W.E. Upjohn Institute, (1990) page 55.

<sup>73</sup> Ibid, page 2.

<sup>74</sup> Ibid Chapter 1.

<sup>75</sup> Ibid page 21.

surveyed employers had a two-tiered system in their expiring contracts for that year, that retention or expansion of two-tiered systems remained an active bargaining goal going forward, and that such incidence was generally consistent with prior years.<sup>76</sup>

In my own experience working with major public employers, tiered approaches are also common, particularly with regard to benefits. Eight of the ten largest US cities by population have a multi-tiered pension system, for example, based on employee hire dates. In my work with governments facing fiscal strain, I have also seen wage and paid leave tiers introduced as a mechanism for reducing long-term costs with less disruption for incumbent employees.<sup>77</sup>

When the Postal Service negotiated permanent new tiers for future hires in the 2010-2013 period, the new pay scales were only moderately lower, and paid leave and other benefits were kept the same as for longer-tenured workers. For example, the new NALC pay tier featured longer wait periods between step increments and lower rates of pay at steps prior to maximum, but still reached the same maximum rate over time. For the APWU, the new tier was approximately 10% lower than the previous schedule on average.

Going forward, permanent tiers could potentially be established with overall pay levels more closely aligned with the rates for non-career workers, and potentially adjustments to paid leave more commensurate with market norms. As outlined above, the Postal Service's non-career service pay levels are comparable and competitive with private industry, and have proven to be successful in recruiting over 130,000 employees despite the difficult and unpredictable schedules, lack of job security, and lesser benefits of such non-permanent positions.

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<sup>76</sup> BNA 2016 pages 33-34.

<sup>77</sup> For example: the City of Atlantic City, NJ has negotiated reduced wage tiers for recent hires; the City of Pittsburgh, PA has eliminated longevity and master-level wage premiums; and the City of Philadelphia has reduced public safety worker entry pay rates and lowered sick leave accruals.

In addition, use of the flexible, non-career service structure could potentially be expanded, as took place and helped to contain Postal Service wage costs from 2006 through 2014. More recently, the percentage of non-career employees has declined, thereby increasing average costs and eroding operational flexibility.

While Postal Service career service quit rates are exceptionally low, routine service retirements create regular turnover such that transition to a more affordable and sustainable permanent compensation tier – more consistent with the statutory goal of private sector comparability – could be advanced incrementally over time. According to analysis by the Congressional Research Service,<sup>78</sup> for example, approximately 30,000-40,000 Postal Service career employees separated each year from FY2008 through FY2014. While some of these separations were based, in part, on incentives, approximately 20,000-25,000 career employees separated annually without such incentives. Looking forward, a 2015 OIG report noted:

*“About one half of Postal Service employees are currently over the age of 50. Over the course of the next 10 years, most of these workers will retire, to be replaced by lower paid career and non-career employees.”<sup>79</sup>*

As an update to this OIG finding, review of the Postal Service Active Employee Statistical Summary for Pay Period 04 FY2017 indicates that approximately half of all Postal Service workers (career and non-career service) are still 50 or older, and more than one-third have 20 or more years of service.<sup>80</sup> With this significant percentage of the overall workforce now in line for natural turnover, the opportunity to maximize the potential for more affordable replacement as identified by the OIG remains high. Further, to the extent that the Postal Service can identify

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<sup>78</sup> Congressional Research Service, “U.S. Postal Service Workforce Size and Employment Categories, FY1995-FY2014, October 21, 2015.

<sup>79</sup> USPS OIG RARC-WP-15-004, “Flexibility at Work: Human Resource Strategies to Help the Postal Service,” January 5, 2015, page 13.

<sup>80</sup> Postal Service Active Employee Statistical Summary (HAT Report), Pay Period 04 FY2017, February 21, 2017.

operational economies and efficiencies and/or if service demand were to decline, this dynamic also allows for overall headcount reductions as warranted.

In addition to salaries and wages, the Postal Service also holds multiple opportunities to reduce and control compensation costs through benefits reform.

- While USPS retirement benefits and participation in the FEHB are currently required under federal law, the Postal Service can negotiate and adjust the employer and employee share of premium contributions for healthcare. In recent collective bargaining agreements, the Postal Service has negotiated incremental reductions in its employer share. As noted previously, however, this employer contribution share still remains above the federal contribution to the FEHB for its own employees.
- The USPS can also collectively bargain paid leave benefits, and current offers vacation, holiday, and sick leave benefits more generous than private industry norms. This represents an opportunity for change in an area that contributes to staffing and overtime pressures.
- The Postal Service and USPS OIG have also identified an opportunity for significant savings in Workers' Compensation program medical claims payments associated with pharmaceutical compounding.<sup>81</sup> The Postal Service and OIG attribute recent cost escalation – from just \$9 million in 2013 to \$173 million in charges in 2015 – to inadequate controls over the pharmacy-compounding invoicing process. While this process is under the exclusive administrative control of the U.S. Department of Labor, the USPS reported that it was formally pursuing corrective action as of the end of FY2016.<sup>82</sup>

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<sup>81</sup> USPS OIG, Management Advisory HR-MA-16-003, "Workers' Compensation Compound Drug Costs," (March 24, 2016).

<sup>82</sup> 2016 Report on Form 10-K, page 29.

- For benefit-related cost centers subject to federal mandates, the Postal Service can continue to pursue legislative change to create the flexibility to negotiate all elements of total compensation, inclusive of benefit plan design, so as to reduce cost pressures and better meet the goal of private sector comparability. As the 2003 President’s Commission on the United States Postal Service wrote:<sup>83</sup>

*“It is the Commission’s view that the benefits of comparability are undermined for all parties when significant segments of total compensation are rendered non-negotiable. For bargaining-unit employees, this places disproportionate downward pressure on wages, rather than across wages and benefits. For ratepayers, it is unfair to ask that they finance postal compensation above the generous provisions of the law (i.e., comparability to the private sector).”*

To the extent that many benefits remain outside of the bargaining process with levels and growth rates well in excess of private sector standards, a total compensation perspective on comparability would also warrant sharper action to control cash compensation.

As noted in multiple GAO reports and testimony,<sup>84</sup> impasse in collective bargaining between the Postal Service and its unions is subject to binding interest arbitration, with no formal statutory requirement for arbitration panels to consider the USPS financial condition. In other public sector arbitration outside of the Postal Service, formal provisions requiring weight for fiscal condition have had a measurable impact, and could be beneficial for the Postal Service.

Even absent such a formal provision, however, there is substantial evidence that the USPS financial condition, environment, and constraints contribute to the outcomes of collective

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<sup>83</sup> Report of the President’s Commission on the USPS (2003), page 117.

<sup>84</sup> See, for example, GAO-17-404T, “USPS Key Considerations for Restoring Fiscal Sustainability,” (February 7, 2017), page 13.

bargaining and even interest arbitration. The 2013 NALC arbitration award, for example, outlines contemporaneous financial pressures in detail and notes that the arbitration panel “reviewed both the labor cost and operational need for a flexible, low cost delivery capability to service the changed business environment facing the mailing and package industry” in summarizing the factors underlying its decision.<sup>85</sup> Although the 2016 APWU arbitration award specifically notes the absence of a statutory standard requiring the consideration of fiscal constraints, that arbitration panel also takes note that the Union voluntarily agreed to financial concessions during the prior 2010 round of bargaining when it perceived the USPS to be in “far worse” financial condition.<sup>86</sup> Collective bargaining and impasse resolution do not take place in a vacuum, but rather occur within the context of broader fiscal concerns.

Within just this context, establishing further statutory weight for financial condition in the USPS binding arbitration process would certainly be *helpful* in the shaping of a framework of reasonable incentives for negotiating financially sustainable compensation. At the same time, there is also little question that the removal of existing revenue constraints from the existing fiscal framework would be *harmful* in an opposite direction, creating further imbalance across stakeholder interests and eroding further progress toward private sector comparability.

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<sup>85</sup> 2013 NALC Award, page 10.

<sup>86</sup> 2016 APWU Arbitration Award, page 5.

### **XIII. Summary of Conclusions**

1. USPS pension liabilities are comparatively very well-funded. The Postal Service funded ratio of pension assets to liabilities – 92.5% for FY2014 and 93.1% for FY2016 – is stronger than the equivalent ratios for the federal government, the great majority of state and local governments, and those private employers that still offer defined benefit plans. The USPS reported funded ratio is also well above the private sector standard for being considered at-risk, and would be designated as "strong" for a state government according to the standards used by Standard & Poor's.
2. Similarly, while most public employers have minimal or no prefunding for retiree healthcare, the Postal Service has already reserved approximately 50% of its projected long-term liability.
3. The Postal Service has achieved these strong prefunding levels despite the use of conservative actuarial assumptions, reflective of extraordinary constraints placed on its investment practices. It is remarkable that the USPS has achieved its current funding levels despite these limitations. If the Postal Service retiree benefit liabilities were calculated using a 7.0% discount rate (which is consistent with private sector practice, and at the low end of the range for public pension plans), aggregate USPS retiree benefit assets would already exceed projected liabilities.
4. The Postal Service also has reasonable opportunities to further reduce its retiree benefit liabilities, subject to legislative approval. Full integration with Medicare alone would substantially eliminate the USPS retiree healthcare unfunded liability, and additional savings may be achievable by using Postal Service-specific demographics for developing actuarial assumptions.
5. There is no near-term – or even intermediate-term – budget risk associated with USPS retiree benefit obligations. As of September 30, 2016, the Postal Service held an aggregate \$338.4

billion in assets dedicated for these benefits. Even with no reforms, no legislative change, and no new employer contributions into these funds, the USPS assets already on hand are projected to be sufficient to pay for all retiree benefit costs for the next ten years – and to still leave an estimated \$243.3 billion available as of September 30, 2027.

6. Because of this comparatively strong position, major funding increases are not required to address these balance sheet concerns. To the contrary, the Postal Service is already experiencing savings of approximately \$4 billion annually in reduced contribution requirements for retiree healthcare in FY2017 based on the end of a frontloaded payment schedule that was not actuarially based. Going forward, additional reforms proposed by the Postal Service (such as Medicare integration) hold the potential to reduce these annual payments by approximately \$5 billion more per year. Given that current projections anticipate sufficient benefit funding for decades ahead, these opportunities to reduce the liability should be given time to be fully pursued prior to increasing the USPS revenue requirement to address costs that may never materialize.
7. Beyond retiree benefit liabilities, the USPS balance sheet also understates the value of Postal Service real estate, now presented on a net book value basis rather than on a fair market value basis. OIG estimates and subsequent market trends strongly indicate that this accounting presentation understates the true economic value of these assets by over \$70 billion, and potentially by as much as \$100 billion. These assets provide an important and under-recognized long-term safety net relative to the Postal Service's liabilities.
8. Any actions to address Postal Service balance sheet concerns should be grounded in an accurate understanding of the value of USPS assets and liabilities. Currently, however, the best available estimates of USPS real estate fair market value are based on 2012, broad market indicators, and Postal Service retiree benefit liabilities are not being calculated based on USPS-specific data and demographics.

9. Within the Postal Service operating budget, as a labor-intensive enterprise, the primary cost driver is employee compensation.
10. In turn, USPS compensation costs include a substantial premium above the standard for comparable levels of work in the private sector of the economy. Long-documented in past analyses, my current evaluation of occupational wage data, benefit structures, and quit rates again demonstrates that USPS career Tier 1 employees continue to be compensated at levels well above market.
11. My review of occupational wage data also indicates that the lower levels of pay for USPS non-career Tier 2 employees are much more closely aligned with comparable private sector wages, and would be competitive in the market as the rates for permanent positions. This conclusion is further supported by the Postal Service's ability to fill approximately 130,000 positions at these Tier 2 wage rates, despite no job security, minimal benefits, and unfavorable schedules and working conditions for this cohort.
12. Going forward, the USPS could achieve multibillion dollar savings through strategies including: replacement of retiring Tier 1 workers with future career service hires on a pay schedule similar to the current Tier 2; restructuring compensation for incumbent Tier 1 employees (or, at a minimum, restraining future compensation growth); redesigning employee benefits and/or taking the high cost of USPS benefits into account when negotiating wages under a total compensation framework; and, expanding the use of non-career service employees.
13. The scale of these potential savings from reducing the USPS compensation premium could fund substantial capital investment, postal rate relief, and/or balance sheet improvements, if any, determined to be warranted after a more complete valuation of existing real estate assets and Postal Service-specific retiree liabilities.

14. During the 2010-2013 round of collective bargaining, facing fiscal constraints and pressures, the Postal Service took partial steps in pursuing many of the strategies outlined above. In the NRLCA settlement that initiated the more recent round of bargaining, however, as well as subsequent arbitration awards in line with this pattern, the USPS has slowed – and in some cases reversed – its progress toward reducing its compensation premium.
15. In collective bargaining and interest arbitration, economic context matters. Past USPS negotiation history and arbitration award language demonstrates this reality, consistent with my experience over 25 years of involvement with public sector bargaining and arbitration nationally. Reasonable constraints on Postal Service revenues will provide a counterbalance against pressures to continue and increase the USPS compensation premium. Without such a counterweight, the incentives to negotiate toward the statutory goal of private sector comparability will be greatly diminished.

#### **XIV. Verification**

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 17, 2017.

A handwritten signature in blue ink that reads "Michael Nadol". The signature is written in a cursive style with a clear, legible font.

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Michael Nadol

## Exhibit A

### MICHAEL NADOL

1735 Market Street, 43<sup>rd</sup> Floor, Philadelphia, PA 19103 | 215.567.6100 | nadolm@pfm.com

#### PROFESSIONAL EXPERIENCE

##### **PFM Group, Philadelphia, PA**

2000-Present

Managing Director and shareholder (2002-Present)

Senior Managing Consultant (2000-2002)

- National practice leader for management and budget consulting services within the largest U.S. financial advisory firm serving the public sector. Direct team of over 25 professionals advising federal agencies, state and local governments, public authorities, and nonprofit institutions. Member of the firm's Executive Committee and President of PFM Group Consulting LLC.
- Lead and support client projects, including multi-year financial plan development, fiscal sustainability initiatives, program evaluation, workforce analysis, retiree benefit redesign, and budgeting engagements. Representative projects include: development of a long-range financial plan for the City of Baltimore, MD; senior-level involvement in state-appointed fiscal recovery coordination for the City of Pittsburgh, PA; and expert testimony for the City of Detroit bankruptcy.
- Expert witness in public employee interest arbitration proceedings for state and local governments nationally regarding fiscal and economic trends and compensation comparability. Delivered testimony for arbitration in California, Delaware, Maine, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, and Oregon, and before the Florida labor relations board. Testified as an expert witness in hearings of Presidential Emergency Boards 244 and 248, and in federal District Court.
- Major workforce clients have included: the Cities of New York, Philadelphia, and San Antonio, the New York Metropolitan Transportation Authority, Commonwealth of Pennsylvania, States of Delaware and Tennessee, and Montgomery County, MD.
- Invited speaker on finance and workforce issues at the national conference of the Government Finance Officers Association (GFOA), the Council of the Great City Schools, the National Association of Securities Professionals, National Federation of Municipal Analysts, and numerous state and regional industry groups.

- Member of the Governing Board for the National Resource Network, an initiative of the White House and U.S. Department of Housing and Urban Development to provide technical assistance to economically challenged communities.

**University of Pennsylvania, Philadelphia, PA** 1997 – Present  
Adjunct Faculty, Fels Institute of Government, masters-level public administration program

**City of Philadelphia, Philadelphia, PA** 1992-2000

Director of Finance (1999-2000), Deputy Mayor for Finance (1999),  
Deputy Water Commissioner (1996-1999), Chair of the Labor Relations  
Task Force (1993-1996), Assistant Deputy Mayor (1992-1996)

- As Director of Finance, served as chief financial officer for a city-county government with a \$2.6 billion General Fund budget.
- As Deputy Water Commissioner, oversaw all financial management, human resources, and policy initiatives for a \$400 million, 2,200 employee water, wastewater, and storm water utility.
- As Chair of the Labor Relations Task Force, coordinated all labor relations activities across City government, and directed 1996 round of collective bargaining with municipal employee unions representing over 22,000 employees.
- As Deputy Mayor for Finance and Assistant Deputy Mayor, supported multi-year financial plan development and implementation, and multiple management and productivity initiatives during a period of successful fiscal turnaround.

Prior professional experience included planning for a regional civic engagement initiative (**Greater Philadelphia Urban Affairs Coalition**, Philadelphia, PA, 1991) and development of a court-based mediation service and program management, Kingston, MA, 1987-1990)

## EDUCATION

**University of Pennsylvania, Philadelphia, PA** 1993  
Masters of Governmental Administration  
Stephen B. Sweeney Scholar

**Yale University, New Haven, CT** 1986  
Bachelor of Arts in Political Science  
*Summa Cum Laude*, Distinction in the Major

## CIVIC AND COMMUNITY

- Committee of Seventy, Philadelphia, PA** 2005 – Present  
Board of Directors (2005- Present), Treasurer (2005-2008)
- City of Philadelphia Building Safety Oversight Board** 2015 – Present  
Chair, Appointed by the Mayor
- Commonwealth of Pennsylvania Task Force on School Cost Reduction** 2006-2007  
Appointed by the Governor, Selected as Chair by Task Force Members

## PUBLICATIONS

- "Change to Grow: Baltimore's Ten-Year Financial Plan," Government Finance Review*  
Co-author, with Andrew Kleine and Kristin Barcak, June 2014 (Government Finance Officers Association)
- "Managing Public-Sector Retiree Health-Care Benefits under the Affordable Care Act," Government Finance Review*  
Co-author, with Adam Benson and Jim Link, April 2014 (Government Finance Officers Association)
- "Bringing Numbers to the Table; What Finance Officers Need to Know About Collective Bargaining," Government Finance Review*  
Co-author, with Vijay Kapoor, August 2011 (Government Finance Officers Association)
- Management Innovation in U.S. Public Water and Wastewater Systems*  
Co-editor, with Paul Seidenstat, Dean Kaplan, and Simon Hakim, 2005 (John Wiley & Sons)
- America's Water and Wastewater Industries: Competition and Privatization*  
Co-editor, with Paul Seidenstat and Simon Hakim, 2000 (Public Utilities Reports)

## MEMBERSHIPS

- Government Finance Officers Association  
Appointed adviser to the national Committee on Governmental Budgeting and Fiscal Policy (2014 – Present)
- American Water Works Association  
National Standard Development Committee, Business Practices for Operations and Management (2005-2008)

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM	)	
FOR REGULATING RATES AND CLASSES	)	Docket No. RM 2017-3
FOR MARKET DOMINANT PRODUCTS	)	

**DECLARATION OF DAVID O'SULLIVAN  
ON BEHALF OF GUIDEPOSTS**

I, David O'Sullivan, declare as follows:

1. I am the Postal Affairs Manager for Guideposts. Guideposts is a Connecticut-based religious nonprofit organization that is exempt from income tax under Internal Revenue Code Section 501(c)(3). My business address 39 Old Ridgebury Road, Suite 27, Danbury, CT 06810.

2. I have worked for Guideposts for more than 23 years and have served in my current position for more than four years. My role as Postal Affairs Manager requires that I monitor postage costs for Guideposts' direct mailings, review mailings to ensure compliance with postal regulations, and provide our Board of Trustees and executive team with budget numbers for all postage-related expenses of our programs.

3. Founded in 1945, Guideposts is an outreach ministry that seeks to inspire and encourage people across the globe with positive, faith-filled principals for living. We focus our outreach on segments of the population that most need hope, such as (1) sick children and (2) servicemen and servicewomen in harm's way.

4. For example, through our "Comfort Kits" program Guideposts partners with over 600 hospitals in 49 states to bring specially designed care packages to tens of

thousands of hospitalized children each year. In addition, for over 60 years Guideposts has provided inspiration and courage to our nation's armed forces – both active duty and veteran – through our Military Outreach program. Last year, we supplied VA hospitals, military chaplains, and military bases with more than 1.1 million free booklets and inspirational materials. We have also recently partnered with the National Chaplain Center to begin the development and mailing of a VA booklet for 2017 dealing with issues faced by today's veterans.

5. Direct mail is vital to Guideposts' mission of reaching people of faith and giving them strength to meet life's obstacles. Although we have embraced digital media as a tool for outreach – for example through the OurPrayer Facebook page and the OurPrayer app – mail is the lifeblood of our operation. The primary way in which we share the power of faith is through an expansive variety of publications, including:

- Our flagship *Guideposts Magazine*, as well as several other uplifting magazines in circulation;
- Everyday inspiration from our *Daily Guideposts*, a collection of scripture verses and guidance, and our Daily Planner;
- Numerous book titles, as well as a variety of daily, weekly, and monthly Guideposts newsletters and OurPrayer newsletters;
- Two annual booklets: *Strength for Relationships* (distributed to more than 159,000 people, of which over 38,000 recipients were military) and *Strength for Helping Hearts – Reflections for Caregivers* (distributed to more than 121,000 people);

- Cards and gifts, including over 100,000 signed military Christmas cards mailed to hospitalized veterans and military personnel throughout the United States.

6. We are a large-volume mailer, and rely on the Postal Service for a significant portion of our charitable operations. During FY 2016, 37 percent of Guideposts' income was generated by direct mail fundraising, and mailing of complimentary publications accounted for 43 percent of Guideposts' expenses. Our most important classes of mail are standard nonprofit, nonprofit periodicals, first class, business reply, and bound printed matter. In FY 2016, Guideposts spent approximately \$18.5 million in postage costs.

7. Guideposts has been hurt by the 2007-2009 economic downturn and the rise in postage rates since 2007. We have had to curtail our donor acquisition mailings, causing our active fundraising donor file to decrease by over 40 percent since 2007. Our volume of new donor acquisition mail has fallen by approximately 50 percent during the same period. In addition, Guideposts has been forced to reduce employee staff levels by 30 percent and cut salaries for our employees by an average of six percent.

8. Removal of the CPI cap, which would allow the Postal Service to increase postal rates faster than inflation, would have a crippling effect on our mission. We could not avoid the increased postal costs by substituting electronic channels of communication. For years, Guideposts has tried to offset the decline in mailing by expanding its digital staff and increasing its online presence. However, our donors and our beneficiaries continue to demand print publications and communications. Indeed, we are seeing a movement of younger faith seekers back to print media. The most

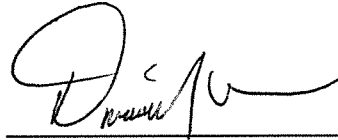
popular version of our *Daily Guideposts*, by far, is our regular print hardcover edition. And the warmth and inspiration generated by things like our signed, personalized Christmas cards to the military does not translate as well to the online channel. Guideposts relies on mail and on the Postal Service, and would see its reach impaired by above-inflation rate increases.

9. Further declarant sayeth not.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 10, 2017

A handwritten signature in black ink, appearing to read "David O'Sullivan", written over a horizontal line.

David O'Sullivan  
Guideposts

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM	)	
FOR REGULATING RATES AND CLASSES	)	Docket No. RM2017-3
FOR MARKET DOMINANT PRODUCTS	)	

**DECLARATION OF MICHAEL K PLUNKETT**

I, Michael K Plunkett, declare as follows:

1. My name is Michael Plunkett. I am Executive Director of the Association for Postal Commerce ("PostCom"). I have held this position since January, 2017.
2. After retiring from the Postal Service in 2013, I worked as a consultant and project leader with Compass, a DC-based non-profit that provides pro bono consulting services for non-profit agencies. Before joining PostCom, I worked as a financial analyst for the Council of Better Business Bureaus.
3. During my 28 years with the Postal Service I held a number of positions including Economist; Manager, Internet Messaging Services; Associate VP of Business Development; Manager, Pricing Innovation; Manager, Pricing Strategy; Acting VP, Pricing and Classification; and Manager, Retail Alliances.
4. The purpose of this declaration is to discuss the development and implementation of the flats sequencing system (FSS), which I observed while employed by the Postal Service, and describe the concerns raised regarding its development at

the time and the Postal Service's response to those concerns.

5. In the lead up to deployment of the flats sequencing system (FSS) in 2008 I was working in the Pricing and Classification function of the Postal Service. In that capacity I attended meetings and presentations regarding the plans to acquire and deploy the equipment. The rationale was intuitively obvious. With First-Class Mail already declining/flattening and delivery point sequencing of letters progressing, further gains from the automation of letters likely to be marginal at best. Thus the largest available pool of manual labor available to be automated was the costs associated with sorting flats by letter carriers to prepare for delivery.

6. From the outset of the FSS project there was significant skepticism that the proposed technology would achieve the intended results and concern that substantial capital was being invested in a system that would unnecessarily complicate a network that already needed to be rationalized. Concerns about the size of the equipment's footprint, cost and complexity were expressed but largely dismissed as problems that could be solved during the design and implementation of the FSS system.

7. It was widely recognized that flats presented a fundamentally different automation challenge for several obvious reasons:

- With substantially less volume, the fixed costs of the equipment would be spread over many fewer units.
- Physically flats are much less uniform than letters. There is more variation in size and thickness and unlike letters flats are open on three sides.

- A larger proportion of flats are entered by commercial mailers who make use of worksharing incentives, particularly carrier route sortation. Consequently, the necessary concentration of volume required to achieve savings would require additional handlings with important cost and service implications.

8. With the benefit of empirical observation it is clear that these concerns were valid and that there was inadequate consideration of the risks of unforeseen volume loss.

**VERIFICATION**

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 19, 2017.

  
Michael K Plunkett

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM	)	
FOR REGULATING RATES AND CLASSES	)	Docket No. RM2017-3
FOR MARKET DOMINANT PRODUCTS	)	

**DECLARATION OF QUAD/GRAPHICS**

Quad/Graphics respectfully submits this declaration in the ten-year review proceeding. Quad/Graphics is a global marketing services provider that helps brand owners market their products, services and content more efficiently and effectively by using our strong print foundation in combination with other media channels.

Headquartered in Sussex, Wisconsin, which is just west of Milwaukee, our company has approximately 22,600 full-time equivalent employees working from more than 60 print-production facilities throughout North America, South America and Europe. With a consultative approach, worldwide capabilities, leading-edge technology and single-source simplicity, Quad/Graphics has the resources and knowledge to help a wide variety of clients in distinct vertical industries, including but not limited to retail, publishing, insurance, financial and healthcare.

Quad/Graphics pioneered co-mailing 30 years ago and our co-mail volumes for Periodicals, USPS Marketing Mail and Bound Printed Matter now exceed 5.4 billion pieces per year of which 4.6 billion pieces are flat mail. The co-mail process combines mailstreams from multiple customers into a single, highly efficient mailstream that

the Postal Service handles at very low cost. These mailings (frequently containing more than 12 million pieces) consist primarily of Carrier Route bundles assembled on large SCF/FSS pallets. We then transport these pallets to – and enter them at – destination sectional center facilities.

The major improvement in co-mailing for Quad/Graphics and the broader industry in recent years is its increased flexibility. Pools can now be created on a more customized and flexible basis to accommodate a greater range of mail classifications, mailing sizes, formats and versions, including catalog and periodical classifications, saddle-stitched and perfect-bound products, larger tabloid-sized and polywrapped mail, as well as specialized formats. Mailings that were locked out of a co-mail solution in the past now can be accommodated. This also includes time-sensitive (e.g., weekly) publications that can now be co-mailed “inline” as part of the mailpiece manufacturing (i.e., binding) process.

Due to the increased flexibility in co-mailing, the choice of whether to participate is now made based almost entirely on whether the postage savings from co-mailing justify making the adjustments, such as production schedules, that are necessary to align with a co-mail operation. Since the advent of co-mailing, the Carrier Route Basic discount has always provided the substantial majority of these postage savings because co-mailing upgrades a very large volume of mail from 5-Digit to Carrier Route Basic presort. Despite the recent increases in bundle and container rates, this remains the case.

On May 31, 2015, the USPS removed the Carrier Route presort discount for mail in FSS zones, effectively reducing the incentive to co-mail in these zones. Due

to the change in pricing, and therefore the co-mail incentive, we saw an 8.15% reduction in co-mail volume in 2016.

These observations show that the low passthrough underlying the Carrier Route Basic discount has limited the growth in co-mailing and caused flats processing to be more costly for the USPS than it should be. Passing through the entire Carrier Route Basic cost avoidance would result in massive growth in the number of publishers and marketers that participate in co-mailing, and a substantial improvement in the end-to-end efficiency of the flats mailstream overall.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct, and that I am authorized to submit this declaration on behalf of Quad/Graphics.

Executed on March 17, 2017.

A handwritten signature in black ink, appearing to read 'Phil Thompson', is written over a horizontal line.

Phil Thompson  
Director – Postal Affairs  
Quad/Graphics  
Sussex, Wisconsin

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM            )  
FOR REGULATING RATES AND CLASSES        )       Docket No. RM2017-3  
FOR MARKET DOMINANT PRODUCTS            )

**DECLARATION OF BOB ROSSER ON BEHALF OF IWCO DIRECT**

1.     My name is Bob Rosser. I am Director Postal Affairs, Products and Services, at IWCO Direct. My business address is 7951 Powers Boulevard, Chanhassen, Minnesota, 55317-9502. At IWCO Direct, I am responsible for all Postal Optimization, Mail Acceptance, and Logistics operations to support our Direct Marketing clients' mailing requirements. I am also tasked with developing, maintaining, and supporting the company's partnership relationship with USPS for regulatory compliance and service performance.

2.     IWCO Direct is ranked the largest service provider focused exclusively on direct mail printing in the U.S. and Canada by Printing Impressions. In 2016, we mailed 3.65 billion pieces of Standard Mail (now known as USPS Marketing Mail) as well as 110 million pieces of First-Class Mail for our clients. IWCO Direct employs 2,570 people in facilities in Chanhassen and Little Falls, MN and Hamburg and Warminster, PA.

3.     Our clients use Marketing (Standard) Mail for acquisition campaigns to attract new customers, cross-sell and upsell products and services to existing customers, and customer retention campaigns to add value to existing customer relationships. Our clients use First-Class Mail for legal, regulatory, and compliance

communications. Overall, IWCO Direct managed \$788.6 million in postage for our clients in 2016. For a typical IWCO Direct client, postage is 50 to 65% of the cost of the mailpiece, while all other costs (lists, design, manufacturing, etc.) are 35 to 50% of the cost.

4. IWCO Direct's business is dependent on stable and predictable postage rates such as those provided by the CPI-based price cap under the current system of regulation. Our direct marketing clients use the direct mail channel as long as it provides their required return on marketing investment. The cost of postage in any direct mail campaign for our clients represents 50 to 65% of our clients' cost to use the channel. When postage costs go up, our clients move their marketing dollars to more cost effective channels and become more selective in their direct mail targeting, both of which reduce their mail volume.

5. If the Postal Service were allowed to increase its market-dominant rates faster than the rate of inflation, IWCO Direct could suffer significant impacts to its business. IWCO Direct's clients each have a set annual marketing budget, and the portion of that budget dedicated to direct mail needs to cover all production costs as well as postage. Typically our clients build in an inflation factor in setting their budgets from year-to-year, but would not allocate additional dollars to the mail channel if the costs of mail were to rise faster than those of other marketing media. If market-dominant postage rates are allowed to rise faster than inflation, our clients would look to IWCO Direct for production efficiencies (i.e. lower costs) to offset growing postage costs. If we were unable to fully offset increased postage costs

with production efficiencies, our clients would then look to reducing mail volume to stay within budget.

6. Given the magnitude of market-dominant postage price increases that could result from the Commission weakening the inflation-based price cap, we anticipate clients would divert direct mail budget dollars to other channels including mobile, web, social media, etc. to get their numbers. It is a zero sum game for our clients. They have a fixed budget for marketing. If mail channel costs are deemed too expensive, and yield a lower return on marketing investment due to higher postage prices, our clients will move dollars available to other, better-performing channels.

7. Lower mail volumes, with lower profit margins, would require rightsizing our operating and overhead costs including employees and production capacity. These changes would drive more investment in automation to reduce labor cost and a continued shift toward other marketing services, reducing direct mail as a share of our overall business.

8. IWCO Direct has already had to take similar actions in reaction to financial pressures since 2007. In 2007 IWCO Direct's business was limited to being a total package producer of direct mail. We saw a 34% decline in both revenue and direct mail pieces produced between 2007 and 2009 as a direct result of the Great Recession. As a result of the drop in revenue and mail volume caused by the Great Recession, IWCO Direct experienced two separate WARN Act events in 2008, when we were forced to close our facilities in Melville, NY and Elm City, NC. This resulted in the loss of approximately 585 jobs across the two facilities. In total, the

company paid approximately \$3.6 million in pay/benefit/taxes on behalf of employees as a result of these closures. We also carried out a reduction in force across our Minnesota-based operations

9. Since that time, we have significantly grown our business through several means, including acquisition of a competitor, acquisition of equipment assets from a competitor leaving the business, and expanding our service offerings to include marketing agency services that extend beyond the production of direct mail. The fastest growing segment of our business has been these agency services, including creative, data, strategy and analysis, that we provide across a variety of marketing channels. While we remain direct mail biased, we are becoming more and more “channel agnostic,” working with our clients to integrate digital and physical marketing communications into an integrated campaign.

10. While we continue to grow our mail volumes by investing in more efficient production technologies and continuing to refine our industry-leading postage optimization strategies, we are seeing increasing pressure from our clients to reduce manufacturing costs and provide them with strategies to achieve even greater postage savings. In 2016, IWCO Direct engaged in price negotiations with seven of its largest customers that resulted in price decreases ranging from 1% to 17.5%. It is only through adding value for our clients by offering an array of marketing services beyond direct mail production that we have been able to drive revenue growth over the past five years.

11. IWCO Direct has also had to adjust to increasing compliance costs resulting from new USPS regulations and initiatives. As the Postal Service has worked to reduce its own internal cost structure, complying with the resulting regulations in order to continue earning the best postage rates for our clients has required significant investments in systems, software, and processes to support Intelligent Mail Full-Service mailings. When Full-Service discounts became available in 2009, our clients expected that we would make these investments to ensure they continued receiving the lowest possible postage rates.

12. In 2013, we added eInduction, which required systems to manage unique container barcodes and electronic mailing documentation, linking them to appointments at USPS destination entry facilities. In addition, we must support the needs of all of our logistics and transportation carrier partners.

13. In May 2014, we went “live” with Seamless Acceptance which required a cross-departmental development team to change mail manufacturing processes in order to become compliant with Seamless Acceptance requirements. We have incurred added costs as we have expanded staff to monitor our Mailer Scorecard, troubleshoot any anomalies found, and determine root causes of any data or mail preparation errors that could put our company at risk of exceeding quality metric error thresholds.

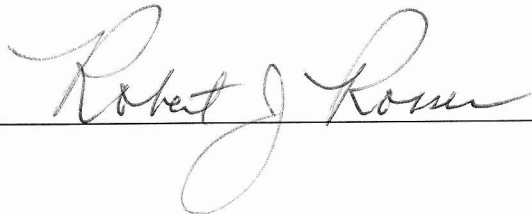
14. The postal rules and regulations we are dealing with now are based on census verification. Data accuracy is critical in this environment, as the data is driving postage payment and verification. Mail Service Providers need to have staff

and procedures in place to ensure the quality of data that is populated in electronic mailing documentation. The automated assessments process for mail quality errors in excess of threshold each month requires more in-process data analytics and data validation to ensure compliance with USPS regulations and to avoid financial risks.

15. While we have worked closely with the Postal Service in the launch of all these programs because we see value in the data they provide and cost savings for USPS operations, it should be pointed out that a significant portion of the costs we have incurred in implementing them have been necessitated by the need to identify and resolve issues with USPS data, systems, and processes.

## VERIFICATION

I, Bob Rosser, declare under penalty of perjury that the foregoing is true and correct. Executed on March 19, 2017.

A handwritten signature in cursive script, reading "Robert J. Rosser", is written over a horizontal line.

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM            )  
FOR REGULATING RATES AND CLASSES        )       Docket No. RM2017-3  
FOR MARKET DOMINANT PRODUCTS            )

**DECLARATION OF WENDY SMITH ON BEHALF OF PUBLISHERS  
CLEARING HOUSE**

1.     My name is Wendy Smith. I am Assistant Vice President Fulfillment & Postal Affairs, Publishers Clearing House (“PCH”). My business address is 382 Channel Drive, Port Washington, New York, 11050. At PCH, I have responsibilities involving postal affairs; merchandise fulfillment, including the third-party managed distribution center; inbound freight logistics and customs compliance, fulfillment systems planning, and customer payment processing. My postal-related responsibilities include holding industry leadership roles in USPS policy, regulatory, and operational activities to advocate the company’s position on factors that impact the value of direct mail as an advertising medium and factors that impact the cost of shipping merchandise sold on free-credit.

2.     PCH began as a direct mail company and has since branched out into e-commerce. To support its business, PCH uses multiple mail products, including Standard Mail Letters, First-Class Letters, Parcel Select Lightweight, Parcel Select, Bound Printed Matter, and, during the holidays, Priority Mail Parcels and First-Class Parcels. Standard Mail Letters are still the primary advertising vehicle for our commerce business. Almost all the responses to our direct mail promotions still come via First-Class Mail. Much of the strength of our promotions comes from the free-credit/bill-me later offer. As such, our

merchandise fulfillment needs to be least-cost, so 100% of our parcels are shipped via the USPS. The free-credit/bill-me later offers also provide a 4-part payment option. This generates a series of First-Class bills, as well as First-Class payment remittances. Our mail multiplier is 1.6, meaning that for every 1,000 direct mail promotions we send, another 600 mail pieces (including parcels) are generated. The postage multiplier is about 3.0. PCH's annual postage spend exceeds \$150 million, and it employs approximately 350 employees in mail-related portions of its business.

3. The current system of regulating market-dominant rates, including the CPI-based price cap, has provided significant benefits to PCH over the pre-PAEA system. With the CPI price cap, we can better forecast postage increases and establish more accurate 3-Year budget outlooks for the company overall. This provides for better promotional strategy planning and, ultimately, greater success in meeting plan targets. It also provides a greater confidence level to our Board. The pre-PAEA rate case litigation was costly, time consuming, and inefficient for all parties.

4. If the USPS were allowed to increase its market-dominant rates above inflation, we would mail fewer Standard Mail Letter promotions which would create a negative mail multiplier, resulting in fewer First-Class Mail responses, fewer merchandise shipments, fewer First-Class bills, and fewer First-Class customer payments. Thus the impact would not just be on market dominant products, but competitive products as well. At the same time, we would accelerate the investment in our digital channels, of which e-commerce is only part. Our non-commerce digital game properties are the growth area.

5. Like the rest of the economy, PCH has faced significant financial pressures since the enactment of PAEA. Prospect lists of direct mail responders have

deteriorated dramatically, to the extent that prospecting cannot keep up with the attrition of an aging customer base. Thus much effort has gone into maintaining the sales base by expanding affinity related offers.

6. All cost areas have increased, but not by the same magnitude year-over-year as postage. The necessary expansion of affinity offers through selective inserting and 4-color imaging have also increased operating costs. And we have invested postage dollars in additional direct mail touch points in an effort to maintain sales levels.

7. Service disruptions occurred with Load Leveling, and, the change in First-Class Mail service standards which impacts our remittance mail as well as the CRM responses to our direct mail campaigns. The threat of 5-day mail delivery and a transition to centralized delivery had been a huge concern for a while. Either would create mailbox clutter, mailing overlap and a decline in response rates and thus, sales.

8. These financial pressures have forced us to more aggressively reposition our brand and leverage our sweepstakes to expand into lower cost, higher ROI, non-commerce digital properties. These offer multi-platform chances to win through free game plays and web searches. This is now a major focus of the company and presents the largest area of profit opportunity for the future.

9. Additionally, we had five Reductions-in-Force from 2009 through 2011, eliminating 2%, 3% and 4% of the workforce in each of the respective years.

## VERIFICATION

I, Wendy Smith, declare under penalty of perjury that the foregoing is true and correct. Executed on March 17, 2017.

Wendy C Smith

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM FOR  
REGULATING RATES AND CLASSES FOR  
MARKET DOMINANT PRODUCTS

Docket No. RM2017-3

**DECLARATION OF HALSTEIN STRALBERG  
ON BEHALF OF  
ALLIANCE OF NONPROFIT MAILERS,  
ASSOCIATION FOR POSTAL COMMERCE, AND  
MPA—THE ASSOCIATION OF MAGAZINE MEDIA**

(March 20, 2017)

**I. INTRODUCTION AND SUMMARY**

My name is Halstein Stralberg. I am a consultant to Time Inc. on issues related to distribution of magazines through the postal system. Until June 1999 I was a principal at Universal Analytics, Inc. (UAI), a management consulting firm in Torrance, California, and manager of its Operations Research Division. A more detailed biography appears as Appendix C to this declaration.

The purpose of this declaration is to demonstrate that the Postal Service's decision to pursue its failed Flats Sequencing System (FSS) program despite questions and concerns raised by the flats mailing industry, rather than fully embracing comailing, has caused USPS costs of Periodicals and Standard Mail flats to be inefficiently high. Even now the Postal Service could substantially reduce the combined costs of Periodicals processing by phasing out the failed FSS program and properly encouraging mailer worksharing.

On July 16, 2003, I participated in the Industry-USPS Flats Summit to discuss the Postal Service's plans to purchase either Delivery Point Packaging (DPP) or FSS equipment to delivery point sequence flats on automation and industry concerns about this plan.<sup>1</sup> At

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<sup>1</sup> Library Reference ANM *et al.*-RM2017-3/3 contains the 19 presentations, including mine, given at the 2003 summit by the Postal Service, its contractors and flats industry representatives, as well a

the Flats Summit and other venues around the same time, the Postal Service and its vendors assured industry that this deployment would substantially lower its costs for processing and delivering flats to benefit Periodicals and other flats mailers.<sup>2</sup>

Representatives of the flats industry, on the other hand, raised important questions and substantial concerns about the Postal Service's plans and encouraged the Postal Service to instead fully encourage "co-" options, particularly comail, in which multiple mailings are combined to produce highly-efficient Carrier Route (CR) mailings that the Postal Service can handle at very low cost.<sup>3</sup> Despite our questions, concerns, and recommendations, it quickly became clear that the Postal Service planned to move full speed ahead with FSS, rather than encouraging more comailing by fully passing through workshare cost avoidances.

While I, along with others, raised serious questions about the Postal Service's direction back in 2003, the outcome of the FSS deployment has been much worse than I imagined and has resulted in USPS costs for Periodicals and Standard Mail flats being far higher than I believe would have occurred if the Postal Service had moved in the direction of encouraging more worksharing. As I show in the following, FSS prepared Periodicals flats in FY2016 cost an average of almost 17 cents per piece more than CR presorted flats cost in non-FSS zones. FSS flats also cost roughly the same as 5-digit (5-D) flats, having somewhat higher processing and somewhat lower delivery costs. The large reductions in delivery costs that were promised with the FSS program have not materialized and appear very unlikely ever to materialize.

Due to the PAEA price cap, the flats industry has been largely insulated from the impact of the Postal Service's inability to control costs, including the failure of the FSS program. This is appropriate. We should not be punished for a bad decision in which the Postal Service ignored industry concerns.

In Section II below I analyze the assumptions that appear to have been the basis for the Postal Service's rosy predictions of FSS cost savings potential back in 2003. Because these assumptions have turned out to be incorrect, it is extremely unlikely that the predicted benefits will ever materialize. Section III provides a detailed analysis of the cost

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closing section summary.

<sup>2</sup> See, for example, the presentations of Ashley Lyons, on behalf of the USPS, and Mr. Spadine on behalf of Lockheed Martin, one of the potential contractors at the time.

<sup>3</sup> See in particular Anita Pursley's flats summit presentation of an "Alternate Flats Strategy Proposal" and the summit closing session summary.

impact FSS had on Periodicals flats in FY2016. To the extent available data allow, I extend the analysis to Standard Mail flats. Section IV explains why there is still potential for increased CR presortation and reduced costs through Comailing and Cobinding<sup>4</sup>, if the Postal Service will provide appropriate incentives. Finally, in Section V I demonstrate that CR presorted Regular Rate Periodicals flats brought to the destinating SCF currently pay for their own costs.

Based upon the above, the Commission should (1) retain the price cap in its current form to ensure that mailers of flats are not unfairly punished for the Postal Service's FSS mistake; and (2) encourage the Postal Service to abandon the disastrous FSS deployment (not just tinker around the edges) and begin passing through 100 percent of workshare cost avoidances to spur increases in Comailing.

## **II. THE FSS PROGRAM WAS A MISTAKE FROM THE START. ENDING IT CAN REDUCE FLATS COSTS SIGNIFICANTLY**

The Postal Service, when deploying the FSS machines and designating some 5-digit zones for FSS processing, generally picked the zones with highest density and the highest degree of carrier route presortation. The Postal Service took, in other words, the most efficient portion of the flats mailstream and turned it into something much less efficient.

Far from reducing flats costs as the Postal Service had hoped, the FSS program has increased those costs significantly, and there is no evidence that the Postal Service knows a way forward to make the program produce real cost reductions. In fact, FSS productivity has been falling almost every year since the machines were deployed.<sup>5</sup>

When the Postal Service initially promoted the FSS program<sup>6</sup> and claimed it would lead to significant cost reductions, its cost reduction projections appear to have been based on several assumptions, that I and others in the flats industry questioned at the time, and which later events have shown to be invalid:

- *They assumed the volume of flats would be much larger than it is today.* In fact, flats volumes have been drastically reduced, due mostly to the digital revolution.<sup>7</sup>

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<sup>4</sup> Cobinding is a less utilized printer technology that allows co-manufacturing of 2-4 magazines on the same binding line.

<sup>5</sup> See Table 2 in Section III below.

<sup>6</sup> See presentations made by USPS and its contractors at the July 2003 flats summit.

<sup>7</sup> The 2003 summit presentation on "Corporate Flats Strategy" (Author: Rapp) referred to a flats volume

Since the FSS needs large volumes, the Postal Service has had to designate many more zones for each machine than it originally expected. As a result, many delivery units are being served by FSS machines quite far away, leading to extra transportation times and difficulties in meeting service standards.

- *They assumed a much lower percentage of carrier route presortation than exists today.* In other words, the Postal Service did not anticipate the success of Comailing.<sup>8</sup> Even under the rosiest assumptions, FSS would not have been able to improve much on the costs of CR flats. In reality, FSS is adding almost 17 cents per piece to each CR flat converted to FSS.
- *They apparently did not consider that the manual sequencing of flats by carriers, which the FSS was meant to eliminate, costs much less for CR flats than for other flats.* Yet this fact has been demonstrated consistently for many years by the Postal Service's IOCS cost data.
- *They assumed that in an FSS zone, practically all flats would be placed in delivery sequence by the FSS.* In reality, large volumes of flats to FSS zones bypass the FSS and require first manual sorting to carrier route and then manual sequencing by the carriers. The latter operation has become less efficient because the vertical flats cases where carriers used to work have in many FSS zones been removed.
- *They assumed almost all flats would be machinable on the FSS.* In reality, the FSS acceptance rates have consistently been much lower than for other flats sorting machines, such as the AFSM.

Because none of the above assumptions have turned out to be true, it appears extremely unlikely that the high expectations at the start of the FSS program will ever be realized.<sup>9</sup>

Before embarking on the FSS program, the Postal Service had experienced considerable success in automating the delivery sequencing of letter mail. It clearly expected a similar

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of 51.6 billion annually. But total FY2016 flats volume was only a little over 31 billion, including over 11 billion saturation and high density flats that clearly have no need for the FSS. Well over half of the rest is basic carrier route, which I show below is also made much more expensive by the FSS.

<sup>8</sup> In the early 2000's the Periodicals carrier route percentage was around 40%, versus over 60% in recent years.

<sup>9</sup> While I and other industry representatives questioned most USPS assumptions at the 2003 Flats Summit, I at least made one assumption which turned out to be wrong in that I believed the Postal Service intended to maintain the service standards that existed at the time. From that assumption I concluded all the FSS processing would have to be done on Tour 1 (early morning). The Postal Service avoided that by drastically reducing its standards, requiring Periodicals mailers to bring their mail to the destinating processing facility in the morning hours rather than late afternoon in order for the flats to be delivered the following day.

success with flats mail but did not fully consider the differences between letters and the much heavier and more diverse universe of flat mail. Whereas delivery sequencing of letters can be done by machines with high accuracy and small footprint that can be installed in every processing facility and even many DDU's, the automation method devised by the Postal Service for flats required machines that are nearly as large as football fields, require very large volumes and must be run during most of each 24 hour period, rather than just a few hours in the early morning. The machines may be technological wonders, but they have added rather than removed costs to flat mail.

Because of the large investment in the FSS and the great hopes that were attached to them, USPS managers appear still unwilling to admit that the program is a failure. Should the Postal Service be bailed out by removal of the current CPI cap on rate increases, the Postal Service may have no incentive to save costs by giving up the FSS program.

The disappointing results of the FSS program cannot be blamed solely on the sharp loss of flats volume that has occurred in the last ten years. A bigger problem has been the failure of the Postal Service to figure out how to make the FSS machines finalize all the volumes they do receive in the FSS zones. This leads to inefficient manual sorting of flats that would have cost much less if they were still in CR bundles. The diversion of some flats to digital format was going to occur at some point. Without the financial crisis it might have occurred later. But in that case the Postal Service might have bought many more than 100 FSS machines and would have been stuck today with an even bigger problem.

Cost differentials between FSS flats and the much less costly CR flats are documented in detail in the following section. By phasing out and eventually eliminating the FSS program, the Postal Service could restore the Periodicals mailstream to greater efficiency and higher cost coverage. Phasing out the FSS would also allow many Standard Mail flats to return to the far more efficient and lower cost Carrier Route product, as well as improving the efficiency of the remaining Standard Mail flats.

### **III. USPS COST DATA PROVE THAT PERIODICALS FLATS COST SIGNIFICANTLY MORE TO PROCESS AND DELIVER THAN THEY WOULD WITHOUT THE FSS PROGRAM**

In the following I provide estimates, based on cost and volume data from the FY2016 ACR, of the costs that the FSS program has added to Periodicals flats. When all processing and delivery costs are included, an average Periodicals flat addressed to an FSS zone costs over 10.5 cents more than if addressed to a non-FSS zone.

I consider first (Section A) Periodicals flats in respectively CR, 5-D and FSS bundles on the most common container type, i.e., 3-D/SCF/FSS Facility pallets. I show that FSS flats cost 16.81 cents per piece *more* than CR flats and about two thirds of a cent *less* than 5-D flats. Appendix A shows that the results differ only marginally when bundles are on containers with other presort levels and addresses the impact of FSS on the cost of flats with less than 5-D presort. Section B below extends the analysis to Standard Mail flats and Section C provides a brief summary.

### **A. Comparison Of Flats On 3-D/SCF/FSS Pallets**

Assume that flats with similar weight and piece characteristics are in either: (1) a CR bundle destined to a non-FSS zone, (2) a 5-D bundle destined to a non-FSS zone, or (3) an FSS scheme bundle destined to an FSS zone. Assume further that the CR and 5-D bundles are on a 3-D/SCF pallet and that the FSS bundle is on an FSS Facility pallet, the most common container types used for each type of bundle, and that each have incurred similar container handling costs before they arrived at their destinating processing facility.

There are then five types of incurred costs to compare between the CR, 5-digit and FSS flats:

- (1) Direct bundle processing costs;
- (2) Direct piece processing costs;
- (3) “Allied” bundle processing costs;
- (4) “Allied” piece processing costs; and
- (5) Delivery costs.

Table 1 below provides estimates, based on USPS ACR2016 data, of each type of cost for CR, 5-D and FSS flats, as well as the total, converted to per-piece costs, for each category.

According to these estimates, explained further below, FSS flats incur an average cost of 36.43 cents per piece, not including container handling and transportation costs, while the corresponding costs for CR flats are only 19.62 cents per piece, a 16.81 cents difference. For 5-D flats in non-FSS zones, the average cost is 37.09 cents, 0.66 cents more than for FSS flats.

Table 1: Per-Piece Costs Comparison, FSS Vs CR Vs 5-D Flats For flats entered on 3-D/SCF/FSS pallets			
	CR Flats	FSS Flats	5-D Flats

Direct Bundle Processing	\$0.0419	\$0.0119	\$0.0274
Direct Piece Processing	\$0.0023	\$0.159	\$0.1207
Allied Bundle Processing	\$0.0190	\$0.0024	\$0.0072
Allied Piece Processing	\$0.0050	\$0.0360	\$0.0296
Delivery	\$0.1280	\$0.1550	\$0.1860
Total	\$0.1962	\$0.3643	\$0.3709

While there may be ways to reduce FSS costs, the current gap is so large it seems unimaginable that the pledge made by some USPS officials to CR mailers before FSS deployment, that they would not be worse off under FSS, will ever be fulfilled.

The sources of the cost estimates in Table 1 are described below.

#### Direct Bundle Processing Costs.

According to the FY2016 Periodicals flats model (USPS16-11), the average number of pieces per CR, 5-D and FSS flats bundle are respectively 15.4, 14.8 and 30.3.<sup>10</sup> The direct per bundle costs for CR and 5-D bundles entered on 3D/SCF pallets and FSS bundles on FSS facility pallets are 64.5, 40.5 and 36.1 cents respectively.<sup>11</sup> Dividing by the number of pieces per bundle gives per-piece bundle costs of 4.19 cents for CR, 2.74 cents for 5-D and 1.19 cents for FSS flats. Clearly, the direct bundle sorting costs are lower for FSS flats, especially when compared with CR flats.

#### Direct Piece Processing Costs

The Periodicals flats model also provides estimates of piece handling costs for flats at each presort level. Excluding “allied” piece costs, the costs are respectively 0.23, 12.07 and 15.9 cents per piece for CR, 5-D and FSS flats. In other words, FSS piece handling costs are not only much higher than for CR flats, they are almost four cents higher than for 5-D flats.

The surprisingly high FSS related piece handling costs are a consequence both of the rather disappointing productivity rates achieved with the highly automated FSS machines, and the high reject rates. Table 2 below shows the reported FSS productivity and overall acceptance rates in FY2011 through FY2016. As can be seen, productivity declined each year from FY2011 through FY2014, even though FY2011 was the year when most of the

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<sup>10</sup> See sheet “Model Volumes” in the flats model.

<sup>11</sup> See sheet “Summary” in the flats model.

machines were deployed and when most startup problems might be expected to have been resolved. The productivity recovered some in FY2015 but declined again in FY2016. The overall acceptance rate (percent of fed pieces that are finalized on the FSS) has changed little over the years.

In order to significantly improve the FSS productivity and lower FSS costs, the Postal Service would need to find ways to operate each FSS with fewer employees while at the same time raising FSS acceptance rates to a level more commensurate with that achieved by the AFSM.

Table 2: FSS Productivity and Acceptance Rates FY2011 Through FY2016 (Based On MODS Data)		
Year	FSS MODS Productivity Rate (pieces per work hour)	Overall Acceptance Rate
FY2011	833	89.39%
FY2012	816	89.84%
FY2013	798	90.35%
FY2014	766	89.69%
FY2015	797	89.32%
FY2016	768	89.46%

### Allied Processing Costs

In addition to direct piece and bundle processing costs, all flats incur certain “allied” costs that are measured separately by the Periodicals flats model.

“Allied” piece costs are costs incurred in moving sorted pieces from one sorting operation to another or to the carriers after the final piece sort. In FY2016 they were 3.6 cents per piece for FSS flats, versus 2.96 cents for 5-D and 0.05 cents for CR flats.

Similarly, “allied” bundle costs represent the cost of moving sorted bundles to the next bundle sorting operation, or to the carrier in the case of CR bundles. The FY2016 per-bundle allied costs were 7.28 cents (FSS), 10.69 cents (5-D) and 29.22 cents (CR). Dividing by the number of pieces in each bundle type gives per-piece allied bundle costs equal to 0.24 cents (FSS), 0.72 cents (5-D) and 1.9 cents (CR).

### Delivery costs

The FY2015 ACR provided, for the first time, separate estimates of the delivery costs

incurred by Periodicals flats to FSS zones. The estimates were based on the methodology described in Proposal 7 in rulemaking Docket RM2015-16. That proposal, approved by the PRC in Order No. 2839, incorporates the new methodology for attributing city carrier street time costs established in rulemaking Docket RM2015-7.

The Postal Service pointed out in Docket RM2015-16 that the FSS delivery costs estimated by the proposed methodology represent the costs of all flats destinating to FSS zones, including flats that may not actually be finalized by FSS machines. For example, some flats may have been rejected by the FSS machines or diverted by facility management to manual processing for whatever reasons, such as concern about service standards.

To the extent that the FSS deployment was expected to significantly reduce flats delivery costs, the reported delivery costs in FY2015 and FY2016 can only be characterized as disappointing. The average delivery cost for flats to FSS zones in FY2016 is reported as 15.5 cents per piece, versus only 12.8 cents per piece for CR flats to non-FSS zones, even though the latter require manual sequencing by the carriers while no sequencing is supposed to be required by carriers for flats that have been placed in walk sequence by the FSS.<sup>12</sup> For 5-D flats to non-FSS zones the delivery costs are 18.6 cents.<sup>13</sup>

## **B. Standard Mail Flats**

Standard Mail and Periodicals flats are generally handled the same way, at the same sorting operations, using the same presort levels for pieces, bundles and containers. One would therefore expect the conclusions reached above for Periodicals flats to also apply to Standard Mail flats. There are, however, a couple of difficulties one encounters in trying to analyze directly the impact of FSS on Standard Mail flats.

First, Standard Mail flats with carrier route presort belong to a different product, called

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<sup>12</sup> It is possible that for flats to FSS zones which do not get finalized on the FSS machines, the resulting manual sequencing is less efficient than the manual sequencing performed by carriers in non-FSS zones, and that this could explain some of the disappointing cost results. Assuring, to the extent possible, that all flats to FSS zones actually get finalized on the FSS, might help reduce FSS delivery costs.

<sup>13</sup> In an earlier version of this analysis, based on FY2012 data, I did not have access to any Postal Service estimates of delivery costs for FSS flats. I therefore developed an estimate based on the evidently far too optimistic assumption that: (1) FSS flats would require no sequencing by carriers since they already have been sequenced by the FSS; and (2) that street delivery of FSS flats would cost the same per piece as the per-piece costs of street delivery by city carriers (cost segment 7) for other flats. Based on those rosy assumptions I arrived at an estimated FSS delivery cost of 3.75 cents per piece, less than one quarter of the Postal Service's own estimate of FY2016 FSS delivery costs.

Carrier Route, whereas flats with FSS preparation are part of the Standard Mail Flats product. The mail flow model for Standard Mail flats covers only flats with FSS, 5-D or lower presort levels, but not CR presort. A comparison between CR and FSS flats based directly on results from the Standard Mail flats model is therefore not possible, since CR flats are not part of that model.

However, as shown below, one can conclude from the Standard Mail flats model that when delivery costs also are considered, FSS and 5-D flats cost roughly the same, as I showed above in the case of Periodicals. Both were shown above to cost far more than if flats were in CR bundles.

The second difficulty is that the Standard Mail flats model does not provide estimates of bundle or container costs. It only calculates per-piece costs. The model also makes the in my opinion inaccurate assumption that bundle sorting and various allied costs are incurred in the same proportion as direct piece sorting costs and therefore can simply be piggybacked on top of the piece related costs.

In Table 3 below the column labeled “Proportional Unit Costs” is taken from a table in the Standard Mail flats model. It gives the unit costs used in USPS library reference 3 of ACR2016 to compare unit cost differentials with discounts given in the rate schedule. The next column gives the estimated unit delivery costs and the last column the combined estimates of per-piece processing and delivery costs.

Table 3: Unit Cost Comparison of Standard Mail Flats By Presort Level, based on FY2016 Standard Mail Flats Model			
Rate Category	Proportional Unit Cost	Delivery Unit Cost	Combined Unit Cost
Nonauto MADC	\$0.3307	\$0.1860	\$0.5167
Nonauto ADC	\$0.2928	\$0.1860	\$0.4788
Nonauto 3-Digit	\$0.2412	\$0.1860	\$0.4272
Nonauto 5-Digit	\$0.1486	\$0.1860	\$0.3346
Nonauto FSS Other	\$0.1929	\$0.1550	\$0.3479
Nonauto FSS Scheme	\$0.1825	\$0.1550	\$0.3375
Auto MADC	\$0.3832	\$0.1860	\$0.5692
Auto ADC	\$0.3233	\$0.1860	\$0.5093
Auto 3-Digit	\$0.2549	\$0.1860	\$0.4409
Auto 5-Digit	\$0.1370	\$0.1860	\$0.3230
Auto FSS Other	\$0.1776	\$0.1550	\$0.3326
Auto FSS Scheme	\$0.1688	\$0.1550	\$0.3238

Let us compare the Standard Mail model's unit cost estimates for the category "Auto FSS Other" with "Auto 5-Digit," the two largest categories by volume of Standard Mail flats. Table 3 indicates FSS flats being more costly, by about one cent, than 5-D flats. This is different from the conclusion presented earlier regarding Periodicals flats where FSS flats came out a little less costly. The difference is mostly due to the fact that the Standard Mail flats model does not estimate bundle costs, assuming instead that those costs are incurred in the same proportion as piece handling costs. And as Table 1 above illustrates, that assumption is not accurate. For example, while both 5-D and CR flats have lower piece handling costs than do FSS flats, the FSS has somewhat lower bundle costs. In Table 1, the direct and allied bundle costs for FSS flats are 2.05 cents lower than for 5-D flats. Applying that adjustment to Table 3, which does not contain bundle costs, we get FSS flats about one cent less costly than 5-D flats, basically the same conclusion drawn above from the Periodicals flats model.<sup>14</sup>

In any case, the combined cost difference between 5-D and FSS flats is very small compared to the much lower costs of CR flats. The fact that large volumes of previously carrier route presorted flats has had to be moved from the low-cost Carrier Route product to the much more expensive Standard Mail flats product where they have re-appeared as FSS prepared flats, is clearly a loss to the Postal Service and to the mailers of those flats.<sup>15</sup>

### **C. Summary**

The main conclusions reached above and in Appendix A can be summarized as follows:

- Based on FY2016 cost data, Periodicals flats in FSS zones cost 16.81 cents per piece more than if they were in CR bundles going to a non-FSS zone. That is if both FSS and CR bundles being compared are entered on 3-D/SCF/FSS pallets. Appendix A below shows that if the FSS bundles are entered on FSS scheme pallets, which 31.97% of them were in FY2016, their per-piece cost is a half cent higher, when the cost of the extra pallet is included in the comparison.

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<sup>14</sup> Unlike the Periodicals model, the Standard Mail model presents separate cost estimates for FSS flats entered on FSS Scheme pallets. It concludes that those on FSS scheme pallets are about one cent less costly, as Table 3 shows. The reason for the difference is that the model assumes an FSS bundle has a bigger probability of actually getting to the FSS if it is on an FSS scheme pallet and therefore able to bypass bundle sorting. The Periodicals model does not make this distinction, but calculates bundle and pallet costs.

<sup>15</sup> In FY2016, FSS flats accounted for over 40% of the volume in Standard flats, even though only about 25% of flats destined to FSS zones.

- Compared with non-FSS pieces with 5-D bundle presort, FSS pieces cost 0.66 cents less, if they are entered on 3-D/SCF/FSS pallets. If the FSS and 5-D bundles are entered on pallets with lower presort, the differential is a little higher, up to three cents if the pallet is an MADC pallet.
- Flats with less than 5-D presort, that eventually will be directed to either FSS processing if it destines to an FSS zone, or incoming secondary sorting and manual carrier casing if it is to a non-FSS zone, will incur fewer costs if they are to a non-FSS zone.

Let us assume, conservatively, that FSS flats cost 16.81 cents more than CR flats (though the difference is a half cent more when FSS scheme pallets are used), that 64.4% of flats are CR presorted, or would be in the absence of FSS, and that the remaining 35.6% of flats cost one cent more without FSS (though some of them actually cost less).<sup>16</sup> Then the average cost added by FSS flats to Periodicals costs in FSS zones is 10.5 cents per piece.

#### **IV. THE POSTAL SERVICE SHOULD ACTIVELY ENCOURAGE FLATS MAILERS TO COMAIL MORE**

The Postal Service should do what mailers have been urging it to do for many years, namely encourage a greater participation by mailers in comail programs, making some of the savings from CR presortation available to more smaller mailers. This will not only increase the volume of CR flats, it will make the stream of CR flats more efficient.

The Postal Service has argued that there is little to gain from trying to incentivize more comailing. In response to questions raised by the PRC in the FY2015 ACD on Flats cost and service issues, it stated that

With respect to generating additional Carrier Route volumes, the comail incentives afforded by the piece/bundle/container rate structure have already picked off the lowest hanging fruit. Mailers that have not currently entered comail pools have chosen not to do so for non-postage reasons, such as the time sensitive nature of the publication. For these reasons, further expanding these incentives by increasing the Carrier Route piece discount is not likely to result in significant

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<sup>16</sup> The FY2016 billing determinants show 64.4% of non-FSS pieces with CRR presort, including some saturation and high density pieces.

growth of Carrier Route volume.<sup>17</sup>

But many mailers disagree with this claim. The reality is that a mailer who decides to use comailing will incur significant non-postal costs and must evaluate whether those costs are sufficiently justified by reduced postal costs. Passing through significantly more than 60% of the cost savings produced by CR presortation would undoubtedly cause more mailers to comail, and will help reduce Periodicals postal costs.

For example, Time Inc. has participated in and promoted comail since the introduction of the technology. Yet six of Time Inc.'s 17 monthly magazines, with 42% (or about 99 million magazines annually) of its total Monthly magazine circulation, are not participating fully in comail today. For these six titles, postage savings realized from comailing are insufficient to justify the required compromises in complexity (reduced versions) and/or distribution schedules. However, if more significant postage savings could be realized, different decisions would likely be made by the titles.

Including the full subscriber count of just one of these large circulation monthly magazines in a printer comail pool would provide:

- An increase of more than 3.2 million carrier route pieces annually
- A decrease of ~850,000 bundles annually
- A decrease of more than 2,600 pallets annually

The time delays that result from participating in a Comailing process rule it out as an option for time sensitive Weekly publications, which contribute 65% of Time Inc.'s total subscriber circulation. However, Cobinding, a less utilized printer technology, is an inline process that optimizes the postal sortation of 2-4 magazines during the binding phase of production. To fully exploit this technology, the magazines must have the same binding/distribution schedules. To date, Time Inc.'s Weekly titles have had very limited participation in Cobinding due to the requirement to align production schedules. If the postage savings derived for Cobinding were more significant, however, some titles would likely decide a change in the editorial close/production schedule, or a 1 to 2 day delay in subscriber copy delivery, is warranted to capture the savings. Cobinding the full subscriber counts of two of Time Inc.'s Weekly titles would provide:

- An increase of more than 8.3 million carrier route pieces annually; and

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<sup>17</sup> Docket No. ACR2016, USPS-FY16-44, Report Responding to Periodicals Pricing Directives (Updated: December 2016) at 5-6.

- A decrease of more than 2.1 million bundles annually

The Postal Service clearly is mistaken in assuming that participation in carrier route presortation by Periodicals mailers already has reached an absolute limit. Note also that a substantial expansion of the CR volume is possible simply by not requiring that the flats to most of the highest-density ZIP codes, with the largest potential for high levels of presort, be prepared for FSS processing.

## **V. SOME PERIODICALS FLATS DO COVER THEIR OWN COSTS**

As is well known, the Standard Mail Carrier Route product, consisting almost exclusively of flats, more than covers its own costs.<sup>18</sup> In the following I show that large volumes of Periodicals CR flats also cover their own costs. Specifically, consider as an example the Outside County flats that have carrier route presort, are entered at the DSCF on 3-D/SCF pallets in a non-FSS zone and pay Regular Outside County rates.

In FY2016, 64.4% of Outside County flats going to non-FSS zones were in CR bundles, and 87.1% of such bundles were on 3-D/SCF pallets/sacks, with an additional 10.1% in the presumably more efficient 5-D/CRTS pallets/sacks. And over 76% of 3-D/SCF pallets are entered at the DSCF. In other words, the flats category defined above represents a very large part of the Periodicals mailstream.

The rates these flats pay and the costs they incur will depend on their weight per-piece and the percentage of editorial discount that they carry. For the purposes of this exercise, let assume that both are averages, which in FY2016 were 0.37762 lb./piece and 65.54% editorial content.

The costs incurred by these flats can be described in terms of the specific services they need from the Postal Service in order to reach their final destination. The unit costs of these services are measured by the Postal Service's Periodicals cost data. These services are:

- *Transportation.* Since these flats are entered by mailers at the DSCF, the only transportation costs are for Intra-SCF transportation, between the SCF and its DUs. According to volume and cost data in ACR2016, Intra-SCF transportation of Periodicals flats cost on the average 4.65 cents per pound.

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<sup>18</sup> In the FY2016 CRA report, Standard Mail Carrier route is shown with a cost coverage of 137.53%.

- *Pallet Processing.* When pallets are brought to the DSCF by mailers, these costs consist of unloading the pallet, moving it to a bundle sorting operation, dumping the pallet and recycling the pallet. Alternatively, if it is a 5-D/CRTS pallet, it may also be required to load it on a truck to the DU, unload it at the DU and bring it to a processing area.
- *Direct Bundle Processing.* Involves the sorting of flats bundles.
- *Allied Bundle Processing.* Moving sorted bundles, typically in rolling Postal Service containers, to the next bundle/piece sorting operation. Although these costs are reported on a per-bundle basis in the Postal Service's cost model, it may be more appropriate to consider them as weight related costs.
- *Direct Piece Processing.* Sorting of flats pieces
- *Allied Piece Processing.* Moving sorted pieces to the next piece sorting operation, or to the carriers. These costs are also more related to weight than to piece counts, although they are reported on a per-piece basis.
- *Delivery.* Includes sequencing by carriers and all subsequent operations to deliver the mail.

The rate elements paid by Periodicals flats to offset these costs are:

- Pound rates;
- Pallet rates;
- Bundle rates; and
- Piece rates.

Table 4 lists the combined per-piece costs for CR presorted Outside County flats entered at the destinating SCF on 3-D/SCF pallets, where it is assumed that the pieces have average piece weight, average percent editorial content, average pieces per bundle for CR bundles and average number of pieces per pallet for 3-digit/SCF pallets. All the costs are based on the Postal Service's ACR2016-1 filing.<sup>19</sup>

The lower part of the table lists the various rate elements that these flats would pay under R2017-1 Periodicals rates. For example, the per-piece charge is 20.2 cents, from which is subtracted an editorial piece discount that in this case is 7.14 cents, given the 65.54% of editorial content. The bundle costs and rates have been converted to a per-piece basis assuming an average of 15.4 pieces per CR bundle. The per-pallet costs and rates have

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<sup>19</sup> The Postal Service often refers to these cost estimates as "bottom up costs."

similarly been converted using an average of 198.59 bundles per 3-d/SCF pallet.

As the table indicates, the combined average per-piece cost for this group of flats is 21.74 cents, while they pay an average charge of 22.97 cents, or 1.34 cents more than their costs. In other words, this category of flats, taken as a whole, more than covers its own costs.

Table 4: Which Outside County Flats Cover Their Own Costs?		
Example: CR Flats entered at DSCF On 3-D/SCF Pallets With:		
Lb/Piece:	0.37762	
% Ed Content:	65.54%	
Costs:	Per-lb	Per-piece
Pallet Handling		\$0.0081
Direct Bundle Processing		\$0.0419
Allied Bundle Processing		\$0.0190
Direct Piece Processing		\$0.0023
Allied Piece Processing		\$0.0005
Transportation (Intra-SCF)	\$0.0465	\$0.0176
Delivery		\$0.1280
Total Costs Per Piece		\$0.2174
Prices:	Per-lb	Per-piece
Pallet Charges		\$0.0078
Bundle Charges		\$0.0358
Piece Charge		\$0.2020
Editorial Piece Discount		-\$0.0714
Editorial Pound Charge	\$0.0865	\$0.0327
Advertising Pound Charge	\$0.0606	\$0.0229
Total Charges Per Piece		\$0.2297
Charges Above or Below Costs		\$0.0124

## **APPENDIX A: FLATS WITH OTHER CONTAINER OR BUNDLE PRESORT LEVELS**

Section III above analyzed the costs of Periodicals flats in respectively carrier route (CR), FSS and 5-digit (5-D) bundles, assuming that those bundles are entered on 3-digit/SCF/FSS pallets. Most Periodicals flats bundles (73.4% according to the FY2016 flats model) are on 3-D/SCF/FSS pallets/sacks. But for a more complete analysis it is necessary to also consider CR, 5-D and FSS bundles that are on pallets with either lower or higher levels of container presort. Note, however, that the two large cost items compared in Table 1 above, namely (1) direct piece costs; and (2) delivery costs, are not affected by container presort. Consequently, changing the assumed container presort will not change the results in Table 1 a great deal.

For a complete analysis of the FSS cost impact it is also necessary to consider flats in bundles with less than 5-D presort.

This appendix extends the analysis to:

- (1) Bundles on ADC/MADC pallets;
- (2) Bundles on 5-D/CRTS/FSS Scheme pallets
- (3) Flats in bundles with lower than 5-D presort

### **1. Bundles on ADC or MADC Pallets or Sacks**

According to the FY2016 flats model, only 2.77% of Periodicals CR bundles were on ADC/MADC pallets/sacks. But 14.51% of FSS bundles and 23.03% of 5-D bundles were entered by mailers in such containers. It is likely, therefore, that most of these FSS bundles were converted from bundles with 5-D presort and relatively few from previously CR presorted flats. The most relevant comparison here is therefore between FSS and 5-D flats. In other words, has the conversion of such flats from 5-D to FSS presort led to significant cost changes?

Before these bundles get to FSS, CR or 5-D processing they must undergo at least one extra bundle sort or possibly two if the original container is MADC. The FY2016 model data in the Periodicals flats model indicate that more bundles are entered on MADC than on ADC pallets. The cost of one bundle sort from MADC or ADC pallets is 36.13 cents. Because FSS bundles have more pieces, on average, than 5-D bundles, the per-piece cost of the extra bundle sort is less for FSS bundles. More precisely, they work out to

1.19 cents per piece for FSS and 2.44 cent per piece for 5-D bundles, a difference of 1.25 cents.

When added to the 0.66 cents per piece difference shown in Table 1, it appears therefore that for bundles that start out on MADC pallets, the combined cost of pieces in FSS bundles may be two cents and in some cases 3.25 cents lower than for pieces in 5-D bundles. But even for these pieces, the costs saved by FSS are quite small compared to the very large costs that FSS has added to formerly CR presorted pieces in FSS zones. The costs saved by FSS are also small compared to the much larger USPS cost avoidances that might have been achieved by converting 5-D bundles to CR presort through a comail program.

## **2. Bundles on FSS Scheme, 5-D or CRTS pallets**

When FSS bundles are placed on FSS scheme pallets, and when CR bundles are placed on CRTS or 5-D pallets, they can bypass the bundle sort, typically performed on an APPS or similar machine, at the DSCF or DFSS. The Postal Service has been actively encouraging mailers to use such pallets, not only because of the avoided bundle sorting costs and reduced bundle breakage, but because of the greater scheduling flexibility they provide. When bundles bypass APPS sorting they can be processed in time for next day delivery even when arriving hours later than the official critical dispatch time. Also, this frees up time on the APPS machines for the Postal Service's growing and profitable parcel business.

In FY2016, 31.97% of Periodicals FSS scheme bundles came on FSS scheme pallets, while 10.13% of CR bundles came on CRTS/5-D pallets. The high use of FSS scheme pallets may be due in part to the strong incentives provided by the Postal Service.<sup>20</sup> In the following I examine the unit cost impact of FSS scheme and CRTS pallets and address the question of whether use of these pallets substantially affects the cost relationship between FSS and CR flats.

Use of FSS scheme and CRTS pallets leads to the use of many more pallets, each of which adds some pallet handling costs. FSS scheme pallets entered at the destinating FSS cost \$13.81 in FY2016, according to the Periodicals flats model. However, about 14% of them were entered at the DSCF when the DSCF was separate from the DFSS,

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<sup>20</sup> Additionally, when the Postal service selected zones in which to implement FSS, they generally picked zones with high density and the greatest possibility for having enough volume to make up 5-d pallets to the given zones.

and the cost of those pallets was \$31.75, giving an average cost of FSS scheme pallets equal to \$16.28. The flats model data indicate 878 pieces per FSS scheme pallet, giving an average cost of 1.85 cents per piece added by the use of FSS scheme pallets.

On the other hand, the FSS scheme pallet eliminates the 1.09 cents per piece in direct bundle processing costs shown in Table 1. It also eliminates 0.24 cents in allied bundle costs. The net cost effect is therefore to add  $1.85 - 1.09 - 0.24 = 0.52$  cents per piece to FSS costs. In other words, if one believes the Postal Service's cost data on Periodicals pallets, the use of FSS scheme pallets cannot be justified on the basis of costs alone, though there may be other reasons for the use of such pallets as discussed briefly above.

For CR bundles, a CRTS/5-D pallet costs \$40.07 when entered at the DSCF. The model data indicate an average of 1031 pieces per CRTS pallet, making the cost of such pallets equal to 3.89 cents per CR piece. But a CRTS pallet also reduces some costs. Bypassing the bundle sort at the DSCF reduces the 4.19 cents per piece shown in Table 1 as direct bundle costs to 1.85 cents, a net reduction of 2.34 cents per piece. Additionally, because the CR bundles are transported to the DDU on the CRTS pallet rather than in some Postal Service container, the allied bundle handling costs are reduced by 1.58 cents per piece. This gives a total cost avoidance of 3.92 cents, just enough to outweigh the 3.89 cents per piece added by the use of the pallet.

To summarize, the use of CRTS pallets for CR bundles is just barely cost justified while the use of FSS scheme pallets is not, in fact it adds about a half cent to the total FSS per piece cost, making the cost difference between FSS and CR flats even worse than when bundles are entered on 3-D/SCF/FSS pallets.

I have based the above analysis on pallet costs derived from the Postal Service's ACR2016 filing. I cannot, however, leave this subject without repeating my long held belief that pallet costs derived from the Periodicals flats model are too high because they are based on outdated productivity rates for pallet handling that lead to much higher costs than those used by the Postal Service for other purposes, such as to determine dropship discount rates for Standard mail.<sup>21</sup> See MPA comments in Docket No. R2015-4 at 2-4. If one were to use the newer productivity rates, use of CRTS pallets would appear much more cost efficient and the cost differential between CR flats on CRTS pallets and FSS

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<sup>21</sup> The pallet productivity rates used to estimate Standard mail dropship savings, as well as for other purposes, were approved by the Commission as Proposal Ten in Docket No. RM2015-3. Appendix B provides an earlier analysis I wrote on this subject.

flats on FSS scheme pallets would be even larger.

### **3. Flats With Less Than 5-D Presort**

The last category of flats to consider is those with an initial bundle sort level of less than 5-D, i.e., flats in 3-D, ADC or MADC bundles. Such flats cannot go directly to either an FSS or 5-D sorting operation. They must first be sorted at least once in a primary flat sorting operation mostly performed on AFSM machines. If such a flat is destined to an FSS zone, it should end up, after its last AFSM sort, in a tray marked for an FSS scheme. If it is not to an FSS zone it should end up in a tray marked for a 5-D sorting scheme.

To compare the costs such a flat would experience if going to respectively an FSS or 5-D operation, we can still use the comparison shown in Table 1 between FSS and 5-D flats, except that there are no bundle processing costs to compare, only the direct and allied piece costs and the delivery costs. Adding the direct and allied piece costs and the delivery costs in Table 1, we can conclude that the remaining costs for these flats, after they leave the last AFSM sorting operation, are 35 cents per-piece if the next operation is FSS, versus only 33.63 cents if it is a 5-D sort to a non-FSS zone. In other words, also for these least presorted flats we conclude that the FSS has added to their total costs, about 1.37 cents per piece.

## APPENDIX B

### THE PERIODICALS FLATS MODEL SUBSTANTIALLY EXAGGERATES THE REAL COST OF HANDLING PALLETS

The following analysis was written in early 2015. While it refers to FY2013 and FY2014 cost data and the postal rates in force at that time, the main points made regarding pallet productivities used in the Periodicals flats model are equally relevant today.

The Periodicals flats model provides estimates of unit costs of pallets and sacks at various presort levels and entry points. These cost estimates serve as a guide to the PRC and the Postal Service for setting Periodicals pallet and sack rates. Unfortunately, the model currently relies on decades old productivity estimates for operations such as loading or unloading pallets and rolling stock and moving pallets or rolling stock across postal platforms. Such operations have become much more efficient as the Postal Service has upgraded and consolidated container handling capabilities in its facilities. We have long suspected that the model's use of very old productivity rates leads to exaggerated pallet costs, which again has led the Postal Service to charge mailers excessively for the use of Periodicals pallets, particularly highly presorted (e.g., 5-digit) pallets.<sup>1</sup> One effect of the high pallet rates has been that Periodicals mailers today use as few 5-digit pallets as possible, when it is believed that wider use of such pallets could reduce overall Postal Service costs as well as improve service.

The Postal Service also uses productivity estimates for pallets and rolling stock in mail flow models that analyze the costs of Standard mail and parcels. But the productivity estimates in those models have been updated with more current data, most recently in Docket No. RM2015-3. As we show in the following, use of modern productivity estimates for pallets and rolling stock also in the Periodicals model indicates that pallet handling, particularly for 5-digit pallets, costs substantially less than previously assumed, and that mailers who use such pallets currently pay a substantial premium relative to their real costs.

### RECENT DATA ON PRODUCTIVITY RATES AT POSTAL NON-MODS OPERATIONS

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<sup>1</sup> See for example Time Inc.'s comments in ACR2009 and ACR2010.

In 2010 the Postal Service filed Docket RM2010-12, a rulemaking case where Proposal Seven established a mail processing cost model for Standard parcels and NFMs (non-flat-machinable pieces that previously had been priced as flats). In support of that proposal, the Postal Service had conducted a 2009 special study of productivity rates in various operations whose productivity cannot be obtained from MODS data, including pallet handling operations. That study showed pallet handling productivity rates an order of magnitude higher than those assumed in the Periodicals flats model.

There were some questions about the statistical reliability of the results achieved in the 2009 study. The PRC did however eventually approve the use of the data in the mail processing model that had been proposed for Standard parcels and NFMs after making some changes to the model. It also approved use of the same data in three other mail flow models that analyze Standard Mail, Media mail and Parcel Select/Parcel Return Service.

Recently, under Docket RM2015-3, the Postal Service filed Proposal Ten, which replaces the productivity data from the 2009 study, in the Standard mail models where the data currently are used, with the results of a recently (2014) completed study. The 2014 study was conducted at:

10 network distribution centers (NDC), 4 auxiliary service facilities (ASF), 21 processing and distribution centers (P&DC), and 21 delivery units (DU) over a two and one-half year period.

The Postal Service believes the new data has a much higher statistical reliability, besides being more reflective of current operating conditions.

The 2014 study indicates significantly higher pallet productivity rates than did the 2009 study, which again showed much higher productivity rates than those used in the current Periodicals flats model.

For example, unloading pallets at a mail processing and distributions center (P&DC) had a productivity of 53.8 pallets per workhour in the 2014 study, versus only 11.6 assumed in the Periodicals model. For cross-docking pallets at a P&DC, the Periodicals model assumes only 6.7 pallets per hour, versus 36.9 in the 2014 study, etc.<sup>2</sup> The 2014 study

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<sup>2</sup> The measured productivities in the 2014 study were actually 77.202 per hour for pallet unloading, and 52.965 pallets per hour for cross docking. However, the Postal Service in its use of these productivity rates divides by an “overhead” factor that represents the portion of time spent by platform employees on either: (1) breaks; (2) clocking in/out or (3) handling empty equipment. In

also produced productivity rates for loading, unloading and cross-docking of rolling stock, e.g., APCs, hampers, etc. As with pallets, the new data show sharply higher rolling stock productivity rates than those assumed in the Periodicals flats model.

The PRC recently, in Order No. 2315, approved the use of productivity estimates from the 2014 study in four separate mail flow models. They are, the Standard Mail parcels mail processing cost model (USPS-FY13-12), the Standard Mail destination entry cost model (USPS-FY13-13), the Media Mail – Library Mail processing cost model (USPS-FY13-15), and the Parcel Select / Parcel Return Service mail processing cost model (USPS-FY13-NP15).

There has, however, been no proposal filed to apply the same productivity data in the Periodicals flats model, even though that model also depends on productivity rate estimates for the handling of pallets and rolling stock at postal facilities.<sup>3</sup>

#### APPLICATION TO PERIODICALS COSTS

Moving a pallet or rolling container on or off a truck, or across a platform, is done the same way whether the pallet/container contains Periodicals flats, Standard flats, packages or something else. There appears, therefore, to be no good reason why the productivity data collected for use in Standard mail models cannot also be used in the Periodicals flats model. To determine the impact the new sets of productivity rates would have on Periodicals unit cost estimates, I modified the final ACR2013 version of the Periodicals flats model<sup>4</sup> by allowing three choices of productivity rates in the handling of pallets and rolling stock at postal facilities: (1) the productivity rates used in the ACR2013 Periodicals model; (2) productivity rates from the 2009 study referred to above; and (3) productivity rates from the 2014 study described in RM2015-3. A comparison of model results under the three different options is presented below.

##### 1. Impact On Periodicals Pallet Unit Costs

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FY2013 the overhead factor for P&DC platforms was 1.435. Applying it to the above mentioned productivity rates gives 53.8 and 36.9 pallets per hour in unloading and cross-docking respectively. To my knowledge, there was no similar overhead adjustment applied to the Non-MODS productivity rates used in the current Periodicals model. Such an adjustment would have made the difference from the more recent productivity data even larger.

<sup>3</sup> Library reference 11 in the ACR filings includes also Standard and First Class flats models. But unlike the Periodicals flats model, those other models do not produce pallet unit cost estimates and do not use the productivity rates discussed here.

<sup>4</sup> See USPS-FY13-11.PER\_OC.ACR.PRC.xlsx in PRC library reference 3, 2013 ACD.

Table B-1 shows the pallet unit costs estimated by the model for various presort levels, at the most common types of pallet entry point, and under each set of assumed productivity rates.

Consider for example a 5-digit pallet entered at the destinating SCF (DSCF). The Postal Service currently charges Periodicals mailers \$22.88 for each such pallet. The rate is so high that it discourages mailers from using such pallets, even though their use, encouraged by many local postal managers, would in many cases allow faster service and reduce damage. As the table indicates, the Periodicals flats model currently shows a cost to the Postal Service of \$35.57 per pallet, i.e., it suggests that mailers who use such pallets only pay 64.32% ( $22.88/35.57$ ) of their cost.

Table B-1: Pallet Unit Costs In Periodicals Flats Model Under Different Productivity Rates				
Pallet Presort	Entry Point	Source of Non-MODS Productivities		
		ACR2013 Periodicals Model	2009 Study	2014 Study
5D	DDU	\$2.71	\$3.22	\$3.32
	DSCF	\$35.57	\$18.39	\$12.67
	DADC	\$52.25	\$26.14	\$17.53
FSS SCH	DSCF	\$11.89	\$5.57	\$3.82
	DADC	\$28.57	\$13.32	\$8.67
3D/SCF/FSS FAC	DSCF	\$21.26	\$10.75	\$8.24
	DADC	\$37.93	\$18.50	\$13.10
ADC	DADC	\$21.98	\$11.07	\$8.49

Using the pallet productivity rates from the 2014 study referred to above, however, gives a cost per 5-digit pallet entered at the DSCF of only \$12.67 per pallet. If that is correct, then Periodicals mailers currently pay an 81 percent premium above the cost of each DSCF entered 5-digit pallet, even though the Periodicals class as a whole pays considerably less than its total costs.

Similarly, a 5-digit pallet entered at the destinating ADC, for which mailers currently pay \$33.87, costs the Postal Service only \$17.53 based on the 2014 productivity data, while the current Periodicals model suggests a cost almost three times higher, at \$52.25 per pallet.

In the case of a 3-digit (or FSS facility) pallet entered at the DSCF, its cost, including the cost of inducing it at a bundle sorting machine (e.g., APPS) is \$8.24 according to the new data, versus \$21.26 in the present Periodicals model. Mailers currently pay \$12.45 for each such pallet.

Clearly then, if we can assume that the new pallet productivity rates are more accurate than the very outdated rates used in the Periodicals model, the Postal Service ought to be charging mailers much less than it currently does for 5-digit pallets. Current charges for SCF/FSS pallets also appear to be excessive except, of course FSS scheme pallets entered at the FSS, for which mailers currently pay nothing. The model with 2014 study productivity rates indicates that such pallets cost \$3.82 each. Finally, in the case of ADC pallets entered at the DADC, mailers currently pay \$13.908, while with the 2014 data these pallets cost only \$8.49.

## 2. Impact On Other Periodicals Unit Costs

The Periodicals flats model estimates, besides container costs, the direct and allied unit costs for flats pieces as well as bundles. Allied piece costs represent mostly the costs of transporting flats that already have been sorted once to the next piece sorting operation or to the carriers. This transport is mostly done in various types of rolling stock that is loaded, unloaded and moved across postal facilities. Since the productivity rates of such operations, according to both the 2009 and 2014 data described above, are much higher than assumed in the current Periodicals model, allied piece costs become much lower with the new data.

Direct piece costs computed by the Periodicals flats model are not directly affected because the productivity rates that determine piece sorting costs are based on MODS and do not require special surveys of the type described in RM2015-3. The same is true for direct bundle costs. However, with much lower pallet costs as well as allied piece and bundle costs, the CRA adjustment factor used by the model increases substantially, from 1.0374 in ACR2013 model, to 1.2336 when the 2009 data described above are used and 1.2720 with the 2014 data. The result is that direct piece and bundle costs increase by being multiplied by a higher adjustment factor.

Table B-2 shows the direct and allied piece costs for each piece presort level and for each set of assumptions regarding productivity rates. The results are for machinable flats pieces and assume pre-barcoding for all pieces except those in carrier route bundles.

Table B-2: Direct & Allied Piece Unit Costs In Periodicals Flats Model Under Different Productivity Rates				
Piece Presort Level		Source of Non-MODS Productivities		
		ACR2013 Periodicals Model	2009 Study	2014 Study
Direct Piece Costs	MADC	\$0.2593	\$0.3083	\$0.3179
	ADC	\$0.2143	\$0.2548	\$0.2627
	3-Digit	\$0.1877	\$0.2233	\$0.2302
	5-Digit	\$0.1139	\$0.1354	\$0.1397
	FSS	\$0.1343	\$0.1597	\$0.1647
	CR	\$0.0250	\$0.0297	\$0.0306
Allied Piece Costs	MADC	\$0.0684	\$0.0420	\$0.0391
	ADC	\$0.0464	\$0.0278	\$0.0262
	3-Digit	\$0.0397	\$0.0236	\$0.0223
	5-Digit	\$0.0283	\$0.0172	\$0.0161
	FSS	\$0.0321	\$0.0195	\$0.0182
	CR	\$0.0059	\$0.0036	\$0.0034

### 3. Application To The FY 2014 Model Version

I have applied the productivity rates described above also in the FY 2014 version of the Periodicals flats model, as filed in library reference 11 of the 2014 ACR. While the numbers vary somewhat, the conclusions stated above still apply. For example, the unmodified FY 2014 model version gives a unit cost equal to \$39.81 for 5-digit pallets entered at the DSCF, versus \$35.57 in the FY 2013 version. When productivity rates from the 2014 Study are applied, the cost is reduced to \$14.16, more than with the FY 2013 model, but still much lower than what the Postal Service currently charges mailers for 5-digit pallets.<sup>5</sup>

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<sup>5</sup> In general, the FY2014 model shows almost all Periodicals unit costs substantially higher than does the 2013 model. That is due to a higher CRA adjustment factor in the 2014 model. The CRA adjustment factor is essentially the ratio between mail processing costs attributed by the cost system and the costs “predicted” by the model. A higher CRA factor, given very few changes in the model itself, can therefore be interpreted to mean that mail processing of Periodicals in FY2014 was somewhat less efficient than it was in FY 2013.

## **APPENDIX C**

### **BIOGRAPHICAL NOTE**

Halstein Stralberg is a consultant to Time Inc. on issues related to distribution of magazines through the postal system. Until June 1999 he was a principal at Universal Analytics, Inc. (UAI), a management consulting firm in Torrance, California, and manager of its Operations Research Division.

His academic background is in mathematics, with a master's degree from the University of Oslo, Norway in 1963. He received a bachelor's degree in mathematics, physics and astronomy at the University of Oslo in 1961. Most of his professional experience is in the area of management science and operations research. He has directed and performed over 40 years of postal related studies as well as management studies for other clients in government and private industry, including production scheduling and control, corporate planning and finance, investment analysis, design and optimization of transportation systems, health care and computer system design.

Since the passage of the Postal Accountability and Enhancement Act of 2006, Stralberg has prepared a number of studies of Periodicals costs and rate design for Time Inc. which have been filed with the Commission. See Comments On Deficiencies In The ACR2011 Periodicals Flats Model<sup>27</sup>, Comments on the Postal Services ACR2010 Filing;<sup>28</sup>, Comments On Reasons Why the Large Periodicals Rate Increase Proposed in Docket R2010-4 Should be Denied;<sup>29</sup> A Tour of Post Offices Handling Periodicals Mail in

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<sup>27</sup> Dockets No. ACR2011 and RM2012, Comments of Halstein Stralberg on behalf of Time Warner Inc. on Serious Deficiencies In the Proposal Eighteen/ACR2011 Periodicals flats model (February 3, 2012).

<sup>28</sup> Docket No. ACR2010, Initial Comments of Time Inc. on USPS FY 2010 Annual Compliance Report (February 2, 2011), Addendum.

<sup>29</sup> Docket No. R2010-4, Comments of Halstein Stralberg in Behalf of Time Warner Inc. on Reasons Why the Large Periodicals Rate Increase Proposed in Docket R2010-4 Should be Denied (August 17, 2010).

Northern Virginia;<sup>30</sup> Comments On Costing Proposal No. 29;<sup>31</sup> The High Costs of Manual Flats Sorting;<sup>32</sup> Estimates Of Worksharing Related Cost Avoidances For Periodicals Flats,<sup>33</sup> and Recommendations For Improving The Periodicals Class.<sup>34</sup>

Stralberg addressed both the 2003 and 2007 Flats Summits organized by the Postal Service and the Mailers Technical Advisory Committees regarding the likely cost impact of the FSS deployment.

Prior to the passage of the PAEA, Stralberg presented 22 pieces of testimony before the Postal Rate Commission on a variety of postal costing and rate design issues on behalf of Time Inc. and of the United States Postal Service. Since 1987, he has worked in support of Time Inc.'s participation in postal rate cases. He has directed the development of computer models for analysis of postal costs and rate design, participated actively as a member of the joint industry/USPS Periodicals Review Team, as an industry representative in an MTAC data collection on bundle breakage, and in a USPS/Time Warner task force to evaluate the feasibility of tailoring the preparation of Periodicals mailings to the processing methods and sort schemes used in each postal facility.

Stralberg has made extensive visits, including many multiple repeat visits, to over 40 USPS mail processing facilities and has observed all aspects of mail processing operations on all tours, as well as methods of mail collection, acceptance and transportation, and various ongoing postal data collection systems. He estimates that in total he has spent more than 2000 hours on site in postal facilities. In late 2009 and early 2010 he joined, as the only industry representative, a task force of USPS and Postal Regulatory Commission personnel touring postal and mailer facilities to review the

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<sup>30</sup> Docket No. ACR2009, Initial Comments of Time Inc. on ACR2009 Pursuant to Order 380 (February 1, 2010). Addendum.

<sup>31</sup> Docket No. RM2010-6, Initial Comments of Time Warner Inc. in Response to Order No. 363 (January 11, 2010), Appendix.

<sup>32</sup> Docket No. RM2009-10, Initial Comments of Time Warner Inc. in Response to Order No.269 (August 20, 2009), Appendix.

<sup>33</sup> Docket No. ARC2008, Initial Comments of Time Warner Inc. on ACR2008 in Response to Order No. 161 (January 30, 2009), Addendum.

<sup>34</sup> Docket No. RM2008-2, Initial Comments of Time Warner Inc. in Response to Order No. 99 (September 8, 2008), Addendum.

preparation and processing of Periodicals.

From 1973 until 1987, he directed UAI's efforts under several contracts with the U.S. Postal Service. His activities under these contracts included:

- Design and development of the Mail Processing Cost Model (MPCM), a weekly staffing and scheduling computer program for postal facilities, with an annualized extension (AMPCM), using linear programming for long term staffing planning in a postal facility.
- An extensive data collection in 18 postal facilities designed to (1) establish a Postal Service data base on mail arrival rates and mail attributes affecting costs (subclass, shape, indicia, presort, container method, etc.), and (2) develop the model input data needed to apply MPCM for each facility.
- The "Study of Commercial Mailing Programs" under the Long Range Classification Study Program. This study involved a detailed cost and market evaluation of several rate and classification concepts, including various presort concepts, destinating SCF discounts for second class, plant loading and barcoding of preprinted envelopes.
- A BMC cost analysis which resulted in the establishment of the Inter/Intra-BMC parcel post rate differential in R80-1.
- Numerous simulation studies requested by USPS management.

Before joining UAI Stralberg was an Operations Research Analyst at the Service Bureau Corporation (IBM), where he performed several large-scale simulation studies, including a design analysis of the Dallas/Fort Worth Airport's people mover system and simulations to improve design and response time in large interactive computer systems.

As Operations Research Analyst at Norsk Hydro, a Norwegian petrochemical company, his work included design, development and implementation of factory production scheduling systems, studies of transportation and distribution systems and risk analysis of investment decisions.

For three years he was assistant Professor of Mathematics at the University of Oslo.

# VERIFICATION

I, Halstein Stralberg, declare under penalty of perjury that the foregoing is true and correct. Executed on March 15, 2017.

Halstein Stralberg